80-1562

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK
Petitioner

v.

SAMUEL WEAVER and ALICE WEAVER

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER and ALICE WEAVER, *Appellants*

v.

MARINE BANK

(D.C. CIvil NO. 79-0066)

SUR PETITION FOR REHEARING

Present: SEITZ, *Chief Judge,* ALDISERT, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM and SLOVITER, *Circuit Judges*

The petition for rehearing filed by

Appellee

in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

Judges Weis and Garth would grant rehearing.

By the Court,

JOHN J. GIBBONS
Judge

January 26, 1981

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

QUESTIONS PRESENTED FOR REVIEW

1. Is an FDIC-insured non-equity certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5.

2. Unknown to the lending bank, as consideration for acting as guarantors on a business loan, an agreement was signed between the primary obligors and the guarantors giving the guarantors:

(a) the right to use the barn and pasture of the business;

(b) the right to receive 50% of the "adjusted net profits" of the business so long as they remained co-obligors;

(c) the right to receive $100 per month until repayment of the loan; and

(d) the right to veto any future loans to the business; thereby raising the question whether this agreement is a "security" as defined in the Securities Act of 1933, the Securities Act of 1934 and the Securities and Exchange Commission's Rule 10b-5 and, if a security, whether the bank can be held liable.

PARTIES

The caption of the case contains the names of all parties to the proceeding before the United States Court of Appeals for the third Circuit.

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JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was dated December 15, 1980 and entered December 15, 1980. See Appendix D. p. A-43, *infra.*

A petition for rehearing before the original panel and before the court in banc was denied by order dated January 26, 1981, and entered January 26, 1981. See Appendix E, p. A-44, 45, *infra.*

The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Securities Act of 1933, 15 U.S.C. § 77b(1):

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10):

> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation

in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Securities Act of 1933, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the

statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This case is a suit brought by the guarantors of a commercial loan, Samuel and Alice Weaver, against Marine Bank, the lender. The loan was made on March 17, 1978, in the principal amount of $65,000 to Columbus Packing Company, a proprietorship consisting of a wholesale slaughterhouse and retail meat store owned by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo.

Some time prior to the loan closing on March 17, 1978, Raymond and Barbara Piccirillo and the Weavers had entered into an agreement which provided that as consideration for Weavers acting as co-obligors on the loan, Weavers were given the following rights:

1) to use the barn and pasture on the slaughterhouse premises;

2) to receive 50% of the "adjusted net profits" of Columbus Packing so long as Weavers remained as co-obligors;

3) to receive $100 per month until the loan was repaid; and

4) to veto any future loans to columbus Packing.

The bank was never informed of this agreement or its contents.

On March 17, 1978, the bank loaned Raymond and Barbara Piccirillo, doing business as Columbus Packing, the sum of $65,000. A $65,000 demand note was signed by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo d/b/a Columbus Packing Company and was co-signed by Raymond A. Piccirillo and Mary T. Piccirillo. Samuel and Alice Weaver executed an agreement of guaranty which guaranteed payment of the principal debtors to a maximum of $50,000. Collateral for the loan included the pledge by Samuel and Alice Weaver of a $50,000 certificate of deposit issued by Marine Bank. This certificate of deposit, bearing a due date of February, 1984, had been previously purchased by the Weavers on February 28, 1978 at the Corry, Pa. branch of Marine Bank, not for the purpose of using it in the Piccirillo transaction, but rather for the purpose

of having money nearby for the operation of their livestock auction which they operated in that area. Columbus Packing filed bankruptcy on July 21, 1978.

The Weavers filed a complaint, the basis for federal jurisdiction being an alleged violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and, in a motion for leave to file an amended complaint, plaintiffs alleged bank conduct violative of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). This conduct allegedly involved a failure of the bank to disclose to the Weavers prior to the loan closing the financial situation of Columbus Packing. On motion for summary judgment filed by the bank, the district court dismissed the action for lack of jurisdiction, holding that no purchase or sale of a security was involved.

A three-judge panel of the court of appeals, with one judge dissenting, reversed, holding that both the certificate of deposit and the agreement constituted "securities" and that the pledge of the certificate of deposit constituted a "sale". A petition for rehearing was denied by the same three-judge panel, and a petition for rehearing in banc was denied by a majority of the circuit judges with two dissents.

REASONS FOR GRANTING THE WRIT

A. First Question Presented: An FDIC-insured non-equity certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is not a "security" as defined in the Securities Act of 1933 or the Securities Exchange Act of 1934.

1. *Conflict with Other Decisions*

This case is the first decision of the Third Circuit to hold that an FDIC-insured non-equity certificate of deposit, issued by a commercial bank, is a security under the 1933 Securities Act and 1934 Securities Exchange Act (hereinafter, the 1933 and 1934 Acts). This holding is, as noted in the court of appeals' opinion, in direct conflict with decisions of other federal courts of appeals which conclude that such instruments are not securities. *Canadian Imperial Bank*

of Commerce Trust Co. v. Fingland, 615 F.2d 465, 470 (7th Cir. 1980); *Bellah v. First National Bank of Hereford, Texas,* 495 F.2d 1109, 1114-1116 (5th Cir. 1974); *Burrus, Cootes and Burrus v. MacKethan,* 537 F.2d 1262 (4th Cir. 1976), withdrawn as moot 545 F.2d 1388, 1391 (4th Cir. 1976). The decision also conflicts in substance with *Amfac Mfg. Corp. v. Arizona Mall of Tempe,* 583 F.2d 426 (9th Cir. 1978); *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.,* 508 F.2d 1354 (7th Cir. 1975); *McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 (5th Cir. 1974).

The panel itself which decided this case was sharply divided. While the Securities and Exchange Commission has taken the position that certificates of deposit issued by banks are securities, there is nothing in the language of the 1933 and 1934 Acts definitions of a "security" or in the legislative history of those acts to infer that Congress intended bank certificates of deposit to be included as "securities." Rather, an analysis of the 1933 and 1934 Acts as opposed to the Glass-Steagall Banking Act of 1933 discloses two separate and distinct federal schemes of regulation. Both schemes were passed by the 73rd Congress to prevent the recurrence of abuses caused by bank involvement in securities activities which gave impetus to the 1929 stock market crash. The 1933 and 1934 Acts were therefore designed to protect investors in "securities" by assuring that those investors were adequately informed in buying and trading *without* guaranteeing the soundness of their investment; the Glass-Steagall Act was designed to supervise the soundness of banks, to *ensure* deposits against loss through creation of the Federal Deposit Insurance Corporation and to specifically prohibit banks who took deposits from becoming involved in the securities business. This scheme was intended by Congress to sever commercial banking from investment activity.

To treat a certificate of deposit as a security would superimpose on already existing federal and state banking regulatory schemes a second pattern of regulations by the Securities and Exchange Commission, with attendant risks of inter-agency conflict and of the Security and Exchange Commission's want of specialized relevant expertise in this area of banking. *Burrus, Cootes and Burrus, et. al. v. MacKethan,* 537 F.2d at 1265.

In concluding that the certificate of deposit in this case was a "security", the Third Circuit relied upon two premises which are inconsistent with applicable decisions of this Court.

First, the Third Circuit relied almost exclusively upon this Court's decision in *Tcherepnin v. Knight*, 389 U.S. 332 (1967). The application of that case was in error, as the "shares" at issue in *Tcherepnin* were held to be investment in nature because they were withdrawable capital shares, which carried a right to vote and were not entitled to a fixed rate of return since state law tied the payment of dividends to an apportionment of the profits. None of these factors apply to a bank certificate of deposit, which carries no voting rights, pays a fixed rate of interest and does not represent shares in the bank.

The court's misconstruction of *Tcherepnin* was based upon a false impression. The Third Circuit reasoned that when this Court wrote *Tcherepnin* it "must have been aware" that the Administrator of National Banks had in 1966 endorsed the Security and Exchange Commission's view that deposit accounts are securities. In fact, the Administrator had *not* concurred in that position but merely stated it without concurrence.

Secondly, the Third Circuit stated its premise for the opinion as follows: ". . . the federal courts ought to interpret the 1934 Act with a presumption of coverage of any transaction which Congress did not expressly exclude," (Appendix A. p. A-13, *infra*. This premise conflicts with this court's decision in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979) which looked to the economic realities of the transaction to determine whether Congress intended to *include* the particular financial interest, rather than to exclude it. The "economic realities" test of this court, enunciated in *United Housing Foundation, Inc. v. Forman* 421 U.S. 837, 851-852 (1975), was ignored by the court of appeals.

2. Impact on the Banking Industry

The holding of the Third Circuit that a certificate of deposit issued by a commercial bank is a security has wide-spread impact on the banking industry. Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378(a) prohibits investment banking concerns from engaging

in deposit banking activities. Section 16 of that act prohibits banks from underwriting, buying or selling equity securities for their own accounts except under limited exceptions whose parameters would not include a certificate of deposit. The act is designed to divorce commercial banking from investment banking. To eliminate the distinction between equity securities and time deposits, as the Third Circuit has done, places the day to day activities of many commercial banks in accepting time deposits in violation of the Glass-Steagall Act.

The Third Circuit's reasoning that "the 1934 Act defines securities so broadly as to include virtually every transaction in which an investor might expect to receive a return on his money" (Appendix A, p. A12-13, *infra.)* extends federal court jurisdiction to any routine banking transaction in which the bank issues an instrument which constitutes evidence of interest payable because of currency deposited in an account. Such transactions would include interest-bearing commercial checking accounts ("NOW" accounts) and savings accounts. The reach of the securities laws should not be extended into these banking areas intentionally excluded by Congress and treated under a separate and more comprehensive system of supervision under federal and state banking laws, a philosophy adopted by several courts of appeals which have found bank loans evidenced by promissory notes not within the purview of the Securities Acts. *McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 (5th Cir. 1974); *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.,* 508 F.2d 1354 (7th Cir. 1975); *Amfac Mtg. Corp. v. Arizona Mall of Tempe,* 583 F.2d 426 (9th cir. 1978).

B. Second Question Presented:

The Piccirillo Agreement is not a "security" as defined in the 1933 and 1934 Securities Acts.

1. *Conflict with Other Decisions*

The decision that the Piccirillo agreement constitutes a "security" is based upon and seriously misapplies the criteria for a security under the 1933 Securities Act as set forth in *SEC v. W. J. Howey Co.,* 328 U.S. 293, 301 (1946) and as extended to the 1934 Securities Exchange Act in *Tcherepnin v. Knight,* 389 U.S. 332 (1967), which test requires a "common enterprise with profits to come solely from

the efforts of others." The Piccirillo agreement gave the Weavers the following rights:

(a) to use the barn and pasture of the Piccirillo business;

(b) to receive 50% of the "adjusted net profits" of the Piccirillo business so long as Weavers remained co-obligors;

(c) to receive $100 per month until repayment of the loan; and

(d) to veto any future loans to the Piccirillo business.

The agreement, signed in the Weaver's trailor, was strictly between Mr. and Mrs. Piccirillo, who operated a slaughterhouse and Mr. and Mrs. Weaver, who ran a cattle auction. *Howey* and numerous courts of appeals cases agree there cannot exist a "common enterprise with profits to come solely from the efforts of others" when a private agreement is reached with a single party rather than multiple investors, which agreement is not publicly offered, not advertised, not offered or sold, not distributed, and involves no pooling of assets. This Court and the courts of appeals indicate that at least one or more of these factors must be present. *Howey, supra, Tcherepnin v. Knight,* 389 U.S. 332 (1967); *Hirk v. Agri-Research Council, Inc.,* 561 F.2d 96 (7th Cir. 1977); *Milnarik v. M-S Commodities, Inc.,* 457 F.2d 274 (7th Cir. 1972), *certiorari denied,* 409 U.S. 887; *Wasnowic v. Chicago Board of Trade,* 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd. mem.,* 491 F.2d 752 (3rd Cir.), *cert. denied,* 416 U.S. 994 (1974); *SEC v. Continental Commodities Corporation,* 497 F.2d 516 (5th Cir. 1974); *Great Western Bank and Trust Co. v. Kotz,* 532 F.2d 1252 (9th Cir. 1976).

This agreement represents, rather, a private arrangement between two married individuals both engaged in the cattle business - Weaver in selling cattle, Piccirillo in slaughtering them. Weaver obtained the right to pasture and house his cattle on the Piccirillo business property and to veto any future loans to Piccirillos' business. This transaction was individually contracted and tailor-made to suit the needs of both parties. There being no other party to the deal, Weaver pooled his "investment" with no one. This absence of a pooling arrangement, combined with the absence of other factors such as a public offering, advertising or public interest, remove the Piccirillo agreement from the boundaries established by this Court for an investment "security".

The record being undisputed that the bank had no knowledge of the existence of the agreement, the court of appeals erred in not requiring any allegation of scienter or an intent to deceive on the part of the bank in connection with the agreement, in conflict with this Court's decision in *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976). The bank could not have the proper mental state intending to deceive the Weavers in connection with a "security" or scheme which the bank did not know existed. The same reasoning was applied in *Woodward v. Metro Bank of Dallas*, 553 F.2d 84 (5th Cir. 1975), which held a bank cannot be implicated in a 10b-5 violation unless it is aware of the improper activity and its role in furthering that activity. The refusal of the court of appeals to consider the bank's lack of knowledge that the "security" even existed means that any bank lending funds to a debtor involved in market manipulation is exposed to automatic 10b-5 liability. To permit the Third Circuit's decision on the Piccirillo agreement to stand will, therefore, have the immediate effect of making all banks and lending institutions the insurers of their debtors.

CONCLUSION

For these reasons, a Writ of Certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER AND ALICE WEAVER,
Appellants

v.

MARINE BANK
(D.C. Civil No. 79-0066)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Argued September 18, 1980
Before: GIBBONS, WEIS and SLOVITER, *Circuit Judges*
(Opinion Filed December 15, 1980)

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OPINION OF THE COURT

GIBBONS, *Circuit Judge.*

Samuel and Alice Weaver appeal from an order granting summary judgment in favor of Marine Bank (Bank) on their complaint seeking equitable relief against or damages from the Bank. The complaint asserts federal question jurisdiction, alleging that the Bank violated section 10(b) of the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 891, 15 U.S.C. § 78j(b).[1] It also pleads pendant claims for violation of the Pennsylvania Securities Act, Pa. Stat. Ann. tit. 70, § 1-101 et. seq. (Purdon Supp. 1980), and for common law fraud. The district court granted summary judgment on the federal law claim and declined to exercise pendent jurisdiction over the state law claims. We reverse.

I.

Facts and Proceedings in the District Court

Many of the facts are undisputed. Marine Bank, beginning sometime in 1976, made three loans to Columbus Packing Company, an unincorporated business owned by Raymond J. and Barbara J. Piccirillo. Columbus Packing operated a wholesale slaughterhouse and a retail meat market in Corry, Pennsylvania. The loans were secured by perfected security interests in equipment, inventory and accounts receivable, liens on several motor vehicles, and second mortgages on two pieces of real estate. Early in 1978 Robert Santom, newly appointed manager of the Corry branch of Marine Bank, designated the Columbus Packing loans as concerned loans because he did not believe the proprietorship had adequate cash flow and because there was no set repayment program. Besides the outstanding loans, Columbus Packing also had a substantial overdraft position with the Bank. Santom told Mr. Piccirillo that the bank would take possession of its collateral and sell it unless Piccirillo either found a buyer, sold his business and paid the bank, closed the business and sold its assets to pay the bank, or secured additional capital.

1. In a motion for leave to file an amended complaint the Weavers also alleged that the Bank's conduct violated § 17(a) of the Securities Act of 1933, 48 Stat. 84. 15 U.S.C. § 77q(a).

On March 17, 1978, a new loan agreement was executed, whereby the Bank loaned Columbus Packing $65,000 on a demand note signed by the Piccirillos, secured as before, by security agreements covering equipment, inventory and accounts receivable, liens on motor vehicles, and liens on the same two pieces of real estate. Simultaneously Mr. and Mrs. Weaver, who were farmers engaged in auctioning livestock, signed an agreement of guaranty which guaranteed payment of the Piccirillos' debt to a maximum of $50,000. To secure this guaranty, the Weavers pledged to the bank a $50,000 certificate of deposit issued by the Marine Bank to them, payable in six years, and bearing interest at six percent. To purchase this certificate of deposit from Marine Bank's Corry branch, the Weavers withdrew $50,000 from another bank. Aged 79 and 71 respectively, they had no formal education beyond the eighth grade, and had spent their lives as cattle farmers.

Prior to the closing on the loan, guaranty, and pledge, the Piccirillos and the Weavers entered into a written agreement providing that the Weavers were to receive fifty percent of the "adjusted net profits" of Columbus Packing and the sum of $100 a month.

The proceeds of the $65,000 loan were forthwith disbursed to repay loans and overdraft obligations to the Bank approximating $42,800, to pay past due federal taxes, and to pay past due obligations to trade creditors. That left approximately $3,800 for working capital. Four months later, Columbus Packing filed a bankruptcy petition. The Bank's security in property of Columbus Packing or of the Piccirillos is inadequate, and it intends to resort, for the deficiency, to the pledged certificate of deposit.

Turning to the disputed facts, the Bank contends that prior to the closing on the loan and guaranty it disclosed to the Weavers all the Columbus Packing debts of which it had knowledge, that at that time it believed its loans were fully collateralized by the Columbus Packing and Piccirillo properties, and that it had no knowledge whatsoever of the agreement between the Piccirillos and the Weavers. From the pleadings, affidavits, and depositions on file, however, a fact finder could find that at a time the Bank was aware of Columbus Packing's desperate financial condition, and doubtful about the

adequacy of its collateral position, employees of the Bank approached the Weavers and urged them to make an investment in Columbus Packing for the purpose of providing working capital. The Weavers then had no knowledge of or interest in investing in a slaughterhouse business. Further, it could be found that the Weavers initially declined Marine Bank's suggestion that they make such an investment, but were persuaded to pledge their certificate of deposit in exchange for a $65,000 loan to Columbus Packing on the representation that substantially all of the loan would be available to that business for working capital, and on the representation that the existing collateral adequately protected both their interest and the Bank's.

The district court did not conclude that the conduct of the Bank's agents which a fact finder might find, if it occurred "in connection with" the sale or purchase of a security, would not be a violation of section 10(b)(5). The court appears to have assumed, without deciding, that liability might be predicated upon a conclusion that as an insider, having access to information not available to the public, the Bank had a duty to disclose material adverse information, or that even if the Bank were not treated as an insider it might be found to be an aider and abettor in a fraud committed by the Piccirillos. *See, e.g., SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971) (an insider is one who has access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the benefit of anyone); *Monsen v. Consolidated Dressed Beef*, 579 F.2d 793, 799 (3d Cir.), *cert. denied sub nom. First Pennsylvania Bank N.A. v. Monsen*, 439 U.S. 930 (1978) (plaintiffs have the burden of establishing that there has been a wrongful act, and that the alleged aider and abettor knew of and substantially assisted in the wrongdoing); *Landy v. FDIC*, 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (an aider and abettor is liable if an independent wrong exists, he knew of the wrong, and substantial assistance was given in effecting it). Rather, the court concluded that if a wrong occurred, on the undisputed facts as a matter of law it did not take place "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b).

The Weavers urge that a fact finder could hold that the Bank's manipulative and deceptive conduct fell within the proscription in section 10(b) because it was in connection with the purchase of a security from the Piccirillos, and also in connection with the sale of a security to the Bank. If they are right on either contention, summary judgment should not have been granted in favor of the defendant. We address those questions separately, starting with the definition of security in the Securities and Exchange Act of 1934 quoted in the margin.[2]

II.

The Piccirillo Transaction

A fact finder certainly could on the record before us find that the Bank's manipulative and deceptive conduct, if it took place, was in connection with the execution and delivery of an agreement between the Piccirillos and the Weavers by which, in consideration of their pledge of a $50,000 certificate of deposit to enable Columbus Packing to obtain a working capital loan, they were given a fifty percent

2. Section 3(a)(10) provides in pertinant part:

(a) When used in this chapter, unless the context otherwise requires —

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity is likewise limited.

15 U.S.C. § 78C(a)(10). As is here relevant, the definition of security is essentially the same as in §2(1) of the Securities Act of 1933, 15 U.S.C. § 77(b)(1). In any event, the definitions have been considered to be virtually identical. *See, e.g.*, United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 847 n. 12 (1975); Tcherepnin v. Knight, 389 U.S. 332, 342 (1967).

interest in the anticipated profits of the Piccirillos' slaughterhouse. Nor is there any question but that the transaction between the Piccirillos and the Weavers would qualify as a sale. The narrower question is whether whatever interest was sold by the Piccirillos falls within one of the categories of securities set forth in section 3(a)(10). It is a settled rule of construction of that definitional section that the categories are not mutually exclusive. "Instruments may be included within any of [the Act's] definitions, as a matter of law, if on their face they answer to the name or description." *Tcherepnin v. Knight*, 389 U.S. 332, 339 (1967), *quoting SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). More specifically, an interest can be both a certificate of interst or participation in any profit-sharing agreement, and an investment contract. *Tcherepnin v. Knight*, 389 U.S. at 339. We hold that the agreement whereby the Piccirillos and the Weavers each would receive fifty percent of the profits of Columbus Packing could be found by a trier of fact to be either or both.

The classic example of a certificate of interest or participation in a profit-sharing arrangement cited by Professor Loss is a contract whereby the buyer furnishes funds and the seller the skill for speculating in the stock or commodities markets under an arrangement to split any profits. 1 Loss, Securities Regulation 489 (2d ed. 1961). Aside form the brief reference to it in *Tcherepnin*, this clause has not often been considered by the Supreme Court. *Cf. International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 n. 11 (1979). There are, however, ample applications elsewhere of that clause to arrangements which are quite closely analogous to that before us. *See, e.g., SEC v. Addison*, 194 F. Supp. 709, 721-22 (N.D. Tex. 1961) (written agreements in connection with loans to the effect that defendants would cause contracts to be executed conveying to lenders a percentage interest in profits from defendants' mining operations); *William Tell Productions, Inc.*, Sec. Act Rel. 3852 (1957), 3-4 (fractional interest in a percentage of gross revenues to be realized from an exclusive production of a copyrighted television production). No reason occurs to us why a sale of an interest in the future profits of a slaughterhouse ought to be treated differently. In the cited interest or participation in a profit-sharing agreement cases the interest was offered to more persons than a husband and wife. The nature and

size of the offering, however, bears only on whether the interest sold is exempt from registration under the Securities Act of 1933, not on whether the interest is a security. Section 10(b) of the 1934 Act covers both registered and unregistered securities. The Columbus Packing interest is evidenced by a writing calling for a participation in its future profits derived as a result of the Piccirillos' management of the slaughterhouse. A jury could find that it was a certificate of interest or a participation in a profit-sharing agreement.[3]

In contrast with the profit-sharing agreement clause, the investment contract clause has received a fairly extensive exegesis in the Supreme Court. In the leading case of *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), contracts for the sale of units of land in a citrus grove development, coupled with contracts with the promoter for cultivating, harvesting, and marketing the crop were found to be investment contracts. The crop from the entire grove was to be sold, and the net proceeds distributed to the separate land owner in the proportion that the land of each produced the crop. If there is a difference between a profit-sharing agreement and an investment contract, probably it is in the fact that the latter includes transactions such as that in *Howey*, in which the purchaser did not share the profits on his investment with others, but kept the net proceeds himself. The court capsulized the test for distinguishing an investment contract from a mere commercial or consumer transaction as "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301. In subsequent cases the Court has adhered to this test,[4] although recently the justices have differed as to its application to a specific set of facts. In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), a majority of the Court held that an investment in a cooperative

3. We speak in terms of what a jury could find since we review a grant of summary judgment. We do not imply that absent some issue of fact raised by the defendant the issue should not be decided as a matter of law.

4. *See* Tcherepnin v. Knight, 389 U.S. 338 (withdrawable capital shares in savings and loan association are investment contracts); International Brotherhood of Teamsters v. Daniel, 439 U.S. at 558 (1979) (noncontributory, compulsory pension plan is not an investment contract). The *Howey* rule was anticipated in SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943).

housing project was not a security. Justice Powell, writing for the Court, quoted the *Howey* test and further stated:

> The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in *Tcherepnin v. Knight, supra* (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra,* at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, *ibid.* — the securities laws do not apply.

421 U.S. at 852-53 (footnote omitted). Here there is no evidence whatsoever in the record that the Weavers wanted to use or develop the Columbus Packing slaughterhouse themselves. It does not appear that they were issuing their obligations to purchase a business they intended to manage.[5] A fact finder could determine that the Weavers made a $50,000 investment motivated primarily by a desire to earn fifty percent of the profits earned by the use of those funds as working capital in a business run by the Piccirillos.

In rejecting the foregoing analysis the dissenting opinion relies on the fact that the Weavers were to obtain use of the Piccirillos' barn and pasture. If a fact finder were to determine that use of the barn and pasture was a primary rather than an incidental purpose of the transaction, it might well decide in favor of Marine Bank. But unlike the dissent we decline to hold that this record compelled that determination as a matter of law.

5. *Cf.* Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973) purchase of franchise accompanied with significant efforts on part of purchaser was not an investment contract).

Since a fact finder could have found that the Bank engaged in manipulative or deceptive acts or practices in connection with the purchase by the Weavers of a contract for a fifty percent share in the profits of Columbus Packing, and could have found that that contract was a certificate of interest or participation in a profit-sharing agreement, or an investment contract, or both, the entry of summary judgment against the Weavers was improper. That conclusion requires a reversal. Because we are remanding for trial it is also appropriate to address the additional question whether the pledge of a certificate of deposit was a sale of a security.

III

The Certificate of Deposit

Certainly if the manipulative and deceptive acts or practices alleged by the Weavers actually occurred, it was in connection with the pledge of the certificate of deposit. Thus those acts or practices are actionable under section 10(b) unless the pledge arrangement was not a sale, or the certificate of deposit is not a security.

Under the 1934 Act the term purchase includes any contract to buy, purchase, or otherwise dispose of, and the term sale includes any contract to sell or otherwise dispose of. 15 U.S.C. § 78c(13), (14). On March 17, 1978, the Weavers executed an assignment reading in part:

> For value received and intending to be legally bound, the undersigned does hereby sell, assign, transfer and set over unto Marine National Bank (hereinafter called "Bank") all the undersigned's right, title and interest in and to a certain deposit account in the undersigned's name in bank described as follows:
>
> Marine Bank Certificate of Deposit #38240 $50,000.00 due February 1984
>
> together with all monies due and to become due thereon, both principal and interest, as security for the payment of a loan in the amount of $50,000.00 . . .
>
> Payment in full of said note shall render this assignment void; otherwise the same shall be and remain in full force and effect.

We have little doubt that if the Weavers had delivered a forged instrument the Bank would contend vigorously that it had made a purchase within the meaning of the 1934 Act, and that the Weavers ought to be prosecuted by the federal government. There is no reason for treating the Weavers' pledge of a valid instrument differently. Thus we agree with those cases in the Second Circuit which have consistently held that a pledge is a sale. *Mallis v. Federal Deposit Ins. Corp.*, 568 F.2d 824, 829-30 (2d Cir. 1977), *cert. dismissed sub nom. Banker's Trust Co. v. Mallis*, 435 U.S. 381 (1978) (pledge is a contract to sell or otherwise dispose of); *United States v. Gentile*, 530 F.2d 461, 466-67 (2d Cir.), *cert. denied*, 426 U.S. 936 (1976) (pledge is a sale), *See also Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1028-30 (6th Cir. 1979). There are contrary expressions in other courts.[6] We do not find them persuasive, if for no other reason than that there is no reason to presume that Congress intended to exclude lending institutions extending credit on the security of pledged collateral from the protection of section 10(b). If a pledge is a purchase for the purpose of protecting a lender it is equally a sale for purposes of protecting the pledgor. Moreover, most of the courts which have intimated that the pledge transaction is not a sale have conceded that its foreclosure is.[7] In this case since the Bank is the issuer of the certificate of deposit, foreclosure, if it is permitted, will take the form of a mere refusal to honor the certificate of deposit, and the setting off of the liability against the Columbus Packing debts. We conclude that on this record a fact finder could hold that a sale of the Weavers' certificate of deposit occurred.

6. *See, e.g.*, Lincoln Nat'l Bank v. Herber, 604 F.2d 1038, 1044 (7th Cir. 1979); National Bank of Commerce of Dallas v. All American Assurance Co., 583 F.2d 1295, 1299-30 (5th Cir. 1978); Reid v. Hughes, 578 F.2d 634, 638 (5th Cir. 1978); McClure v. First Nat'l Bank of Lubbock, Texas, 497 F.2d 490, 495-96 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975); Rispo v. Spring Lake Mews, Inc., 485 F. supp. 462, 467-68 (E.D.Pa. 1980).

As the dissent correctly notes, the Supreme Court has granted certiorari on the question of whether a pledge of stock to a bank as collateral for a bank loan is an offer of sale for a security under § 17(a) of the Securities Act of 1933. Rubin v. United States, 48 U.S.L.W. 3662 (1980), *granting cert. to* United States v. Rubin, 609 F.2d 51 (2d Cir. 1979).

7. *See, e.g.*, Lincoln Nat'l Bank v. Herber, *supra;* McClure v. First Nat'l Bank of Lubbock, Texas, *supra.*

That leaves the question whether the certificate of deposit was itself a security. We note at the outset that it was issued by Marine Bank. That fact is significant only for purposes of section 3(a)(2) of the Securities Act of 1933, which exempts from its registration requirements securities issued by banks whose issues are regulated by federal or state banking officials. 15 U.S.C. § 77c(a)(2). However, bank securities are not exempt from the antifraud provisions of the 1934 Act. *See* 2 Bromberg & Lowenfels. Securities Fraud & Commodities Fraud. § 6.5(312), at 136.1 (1979).

We can in this case also exclude the exception in the 1934 Act's definition of security for currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months . . ." 15 U.S.C. § 78c(a)(10). The certificate of deposit pledged by the Weavers was certainly not currency. Furthermore, since the issuing bank had no obligation to pay for six years, it did not qualify for the nine month commercial paper exception.

In *Tcherepnin v. Knight,* 389 U.S. 332 (1967), referred to above in our discussion of investment contracts and profit sharing agreements, the Supreme Court held that withdrawable capital shares in a savings and loan association were securities. From an investor's standpoint those shares were the functional equivalents of certificates of deposit, except, perhaps, for the fact that the savings and loan in *Tcherepnin* was a mutual institution in which the depositors had an interest in profits. Here, Marine Bank's obligation is to pay a sum certain and a fixed interest return. It is in form and in fact a long term debt obligation. Although, technically, *Tcherepnin* is not controlling, functionally, from the depositor's standpoint, it is hard to distinguish long term deposit transactions with mutual institutions from similar deposit transactions with banks operated for the profit of stockholders. Moreover, when the Court wrote *Tcherepnin* it must have been aware that the Administrator of National Banks in a Statement of Policy on Advertising for Funds by National Banks, 31 Fed. Reg. 16581 (1966), endorsed the SEC's view that deposit and share accounts of banks are subject to the antifraud provisions of the securities laws. *See* 1 Bromberg & Lowenfels, Securities Fraud & Commodities Fraud, #4.6(382), at 82.15. Finally, we note that the Securities and

Exchange Commission has taken the position that certificates of deposit issued by banks are securities.[8]

Since there is no general antifraud exception for bank securities, and since when Marine Bank borrowed for more than nine months it issued what in all material respects is the functional equivalent of any other corporation's bond or note, we cannot on this record hold that a certificate of deposit evidencing its debt is not, like other long term bonds or notes, a security.[9] Perhaps at trial some distinguishing features may be developed. But certainly on the record before us it was error to grant summary judgment against the Weavers on the ground that the manipulative acts and practices of which they complain were not made in connection with the purchase or sale of a security. As did the court in *Bellah v. First National Bank of Hereford, Texas*, 495 F.2d 1109, 1116 (5th Cir. 1974), we remand "so as not [to] foreclose them from an opportunity to pursue that theory of liability in the district court . . ."

IV.

Other Considerations

A few words are appropriate with respect to the district court's approach to the proper interpretation of the Securities Act of 1934. Throughout the court's opinion granting summary judgment there is a general tone of nostalgia for the days when victims of fraud were relegated to the common law remedy of deceit, and when such actions were tried in state courts under state law standards. This interpretation of the Act is grudging of coverage and is fundamentally at variance with the decision made by Congress in 1934 to place a *national* floor under the level of conduct to which parties dealing in the national investment market might descend. The 1934 Act defines securities so

8. *See* MacKethan v. Peat, Marwick, Mitchell & Co., 439 F. Supp. 1090, 1094 (E.D.Va. 1977), referring to the amicus curiae brief of the Securities & Exchange Commission filed in Burrus, Cootes & Burrus v. MacKethan, 537 F.2d 1262 (4th Cir. 1976).

9. We do not rely on the language "certificate of deposit, for a security" in section 3(a)(1). That language refers to a type of security irrelevant to the issues in this case.

broadly as to include virtually every transaction in which an investor might expect to receive a return on his money. It proscribes misconduct not in terms merely of common law fraud subject to all the vagaries of state law, but in the all-inclusive terms "manipulative acts and practices in connection with a purchase or sale" of a security. Most significantly, it provides in section 27 of the Act, 15 U.S.C. § 78aa, one of those comparatively rare instances in which federal jurisdiction is made exclusive. The message is clear that the federal courts have been given a very special responsiblity for overseeing the level of permissible conduct in securities transactions. The reason for the congressional decision is equally clear considering the doleful pre 1934 history of securities transactions during which Congress, dependent upon state common law remedies for regulation of the level of conduct in securities transactions, watched standards of fiduciary duty and of representations in the market place descend to the level tolerated in the most tolerant jurisdiction.[10] Given the special responsibility entrusted to them, the federal courts ought to interpret the 1934 Act with a presumption of coverage of any transaction which Congress did not expressly exclude. This is especially so when it is remembered that the state courts cannot enforce section 10(b), and thus that the Supreme Court will lack appellate jurisdiction to consider, when a trial is finally concluded in a state court, whether the underlying transaction offended national policy. 28 U.S.C. § 1257.

The federal exclusivity of the section 10(b) remedy is, moreover, a compelling reason why pendent state law claims ought to be heard in the federal court as well, even in states where state law would afford as much or more relief. *See, Cotler v. Inter-County Orthopaedic Association, P.A.*, 526 F.2d 537 (3d Cir. 1975). Thus we must also reverse the district court's dismissal of the pendent state law claims, so that the trial court may reconsider whether their trial should be held in the same tribunal which must consider the section 10(b) claim.

10. *See* A.A. Berle and G.C. Means. The Modern Corporation and Private Property (1932).

V.

Conclusion

The order appealed from, granting summary judgment on the Weavers' section 10(b) claim, and dismissing their pendent state law claims will be reversed, and the case remanded for further proceedings.

Weis, *Circuit Judge*, dissenting.

It should come as no surprise that the panel is divided on the issues in this case because what constitutes a security under the 1933 and 1934 Acts is a matter which continues to trouble courts and commentators. There is no disagreement here about the facts or the inferences that can be drawn from them, except as they shed light on the preliminary clause of the definitions in § 3(a)(10) of the Security Exchange Act: "unless the context otherwise requires." 15 U.S.C. § 78c(a)(10) (1976).

I.
THE PICCIRILLO TRANSACTION

The majority concludes that the interest sold by Piccirillo falls within one of the categories of security set forth in § 3(a)(10), but I am unable to accept that proposition based upon the facts of this case. The agreement here provided that in consideration for agreeing to act as co-obligor on Piccirillo's loan from the bank, Weaver would have the right, as long as Piccirillo was operating and in possession of the Columbus Packing premises:

1. To use the barn and pasture on the packing house premises at the discretion of Piccirillo;

2. To receive 50% of the "adjusted net profits" of the Columbus Packing Company so long as Weaver remained a co-obligor;

3. To receive $100 per month until the bank loan was repaid.

Piccirillo also agreed not to borrow additional money without prior consultation and approval by Weaver.

Certain preliminary observations are in order. The agreement obviously is not in a standard form that could be issued to the public at large. It was tailored to the unique circumstances of the parties, *i.e.*, use of the barn and pasture, as well as Weaver's personal approval of further borrowings. There was no public offering by Piccirillo, but rather a purely private arrangement among individuals — Piccirillo, Weaver, and their spouses — involving no public market or exchange.

Even if the written agreement between the parties could be characterized as a "certificate of interest" or a profit sharing arrangement, it does not follow that the Securities Exchange Act applies. In an analagous situation we held that the statutory definition of a security embracing "every note" cannot be read literally and in context, a "note" may be without the statute. *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973). Similar reasoning requires that the Piccirillo agreement be examined in context to determine if the transaction, however labeled, is within the scope of the Act.

In construing the Securities Act of 1933, 15 U.S.C. § § 77a-77aa (1976), the Supreme Court noted that "courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943) (footnote omitted).

Some years later, the Court emphasized that the focus of the Act is on the sale of securities to raise money for profitmaking purposes, on the exchanges on which securities are traded, and on the need for regulation to prevent fraud and protect investors. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 (1975). Thus, while the statutes are to be construed liberally, application is to turn on the economic realities underlying a particular transaction. *Id.* at 851-52. And as we cautioned in *Lino* "not every plan generating allegations of fraud is a violation of federal securities law." 487 F.2d at 695.

The majority believes that the Piccirillo agreement comes within the Exchange Act designation of an investment contract. In *United Housing Foundation, Inc. v. Forman*, the court reaffirmed the explanation of the type of security that it had discussed in *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946). Describing its formulation as a "shorthand form . . . [of] the essential attributs," the Court defined an investment contract as "an investment of money in a common enterprise with profits to come solely from the efforts of others." 421 U.S. at 852. Application of that definition to the circumstances present here raises two issues: first, whether a "common enterprise" existed when

only two parties were involved in the transaction;[1] and secondly, were the "profits" to come solely from the "efforts of others" when part of the consideration recited was Weaver's right to use Piccirillo's barn and pasture.

Although a security was found to exist in *Howey*, several significant facts in that case contrast starkly with the circumstances at hand. In *Howey*, there was a public offering, an advertising program, sales to persons who were not residents of the state, and, during a 28 month period, purchases by 42 persons. Similarly, in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), where the Court found capital shares in a savings and loan association to be an investment contract within the Securities Exchange Act, the plaintiff class consisted of more than 5,000 investors.

When the number of participants was much smaller, a different result has been reached. The Court of Appeals for the Seventh Circuit in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100 (7th Cir. 1977), concluded that the requirement of a common enterprise includes both multiple investors and a pooling of their funds. In that case, an arrangement through which individual investors deposited funds with a commodity broker in separate discretionary accounts for investment in a profit sharing arrangement was held to be neither an investment contract nor a profit sharing plan within the Securities Act. *Wasnowic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D. Pa. 1972), *aff'd mem.*, 491 F.2d 752 (3d cir.), *cert. denied*, 416 U.S. 994 (1974). *Cf. SEC v. continental commodities corp.*, 497 F.2d 516 (5th Cir. 1974) (multiple investors but no pooling).

The rationale employed by the Seventh Circuit in requiring multiple investors to satisfy the commonality requirement is persuasive, and I would follow *Hirk* for that reason alone. But even more compelling is that the result is in keeping with the general purpose of the Securities

1. In Pennsylvania, property owned by husband and wife is considered to be held as a tenancy by the entireties and the interest of husband and wife considered as one. *In re Holmes Estate*, 414 Pa. 403, 406, 200 A.2d 745 (1964). Hence, both Piccirillos owned the business as tenants by the entireties and the guaranty by the obligors was an entireties obligation.

Exchange Act — to regulate the securities markets where the public trades, and to scrutinize the various arrangements which are offered to the public as investments, *United Housing Foundation, Inc. v. Forman, supra* at 837. In the case at bar, no widespread public interest is affected.[2]The transaction was a face to face encounter involving two parties who made a loan agreement. *See Great Western Bank and Trust Co. v Kotz,* 532 F.2d 1252, 1262 (9th Cir. 1976) (Wright, J., concurring). Here there is no distribution of a widely offered instrument commercially known as a security, as is the case with the various schemes involving transactions regulated by the Act. *See e.g., SEC v. C.M. Joiner Leasing Corp., supra* at 352-53; *Hirk v. Agri-Research Council, Inc.,* supra at 103; *SEC v. Koscot Interplanetary, Inc.,* 497 F.2d 473 (5th Cir. 1974). In addition, there is no suggestion that the laws of Pennsylvania do not provide for an appropriate resolution of the dispute in this case. Indeed, as the majority notes, the plaintiff included pendent state claims in his complaint.[3]

The second issue, whether the profits were to come from the sole or essentially management efforts of others, *see SEC v. Glen W. Turner Enterprises,* 474 F. 2d 477 (9th Cir. 1973), is not per se as important a factor in this case. Were that issue standing alone, I would be inclined to

2. *See* FitzGibbon, What is a Security? A Redefinition Based on Eligibility to Participate in the Financial Markets. 64 MINN. L. REV. 893 (1980).

3. The Pennsylvania Securities Act provides:

"It is unlawful for any person in connection with the offer, sale or purchase of any security . . . (a) to employ any device, scheme or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person."

PA. STAT. ANN. tit. 70, § 1-401 (Purdon Supp. 1980).

The Pennsylvania definition of a "security", 70 PA. STAT. ANN. tit. 70, § 1-102, is broader than that in the federal acts and is not preceded by the phrase "unless the context otherwise requires."

follow the philosophy of the court in *Safeway Portland Employees Federal Credit Union v. C.H. Wagner & Co.* 501 F.2d 1120 (9th Cir. 1974), and apply the "package" concept to the various benefits that Weaver was to receive. There, the court held that the sale of interest bearing certificates of deposit, combined with a bonus agreement to pay additional interest on the transaction, was an investment package that qualified as a security. *Id.* at 1122.

If the other circumstances of the case at hand were not involved, the 50% share of the profits would carry the day on a similar basis. But more weight being given to Weaver's right to Piccirillo's barn and pasture is warranted when the arrangement is viewed in toto. Obviously, that benefit was of more value to Weaver than it would be to an out of state resident or to a person who had no connection with cattle raising. It is more in the nature of a "personal use" accomodation, shaped to fit the particular needs of the private parties involved. Thus, the arrangement between Weaver and Piccirillo does not have an equivalent money value to all persons, another characteristic generally attributable to true securities. *See United Housing Foundation, Inc. v. Forman, supra* at 851. Moreover, when this factor is added to the lack of such features as common enterprise, use of a public market, public offering, and need for federal regulation, the conclusion is inescapable that the transaction between Weaver and Piccirillo does not qualify as a security within the meaning of the Securities and Exchange Act.

II.

THE CERTIFICATE OF DEPOSIT

Section 3(a)(10) of the 1934 Act includes among its definitions of security, "certificate of deposit, for a security." The majority is correct in not relying on this language as a basis for its finding that the certificate of deposit under scrutiny here falls within that clause. The certificate in this case is an entirely different obligation, being a type of time deposit with a bank, rather than a receipt for a security as that term is used in the statute.

The majority does rely to some extent on the fact that the certificate is not due until six years after issuance, and that the Act's exclusion of obligations having a maturity of less than nine months is therefore

inapplicable. The negative inference that the certificate is a security because it is not expressly exempted, however, is not determinative. That is, a note payable in less than nine months may be a security in some situations while a similar obligation of a longer maturity may be outside the Act's ambit in other cases. *McClure v. First National Bank of Lubbock*, 497 F.2d 490, 495 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975).

Nor do I believe that *Tcherepnin v. Knight, supra*, holding that withdrawable capital shares in a savings and loan association were securities, controls here. In the majority's view, from the depositor's standpoint the certificate of deposit is functionally equivalent to savings and loan shares. I do not find that argument persuasive because *Tcherepnin* stressed two important considerations—the shares did not entitle the holders to a fixed rate of return but only a share of the profits, and secondly, the shares were transferable. Moreover, the court cited legislative history supporting its position that savings and loan associations were to be governed by the anti-fraud provisions of the Securities Act. Unlike *Tcherepnin*, no such references can be made to certificates of deposit of a commercial bank. In addition, the Marine Bank certificate bears a fixed rate of interest and represents the bank's obligation to pay a long term debt. It therefore is more akin to a savings account than to the bank's capital stock.

The courts of appeal are not unanimous in their approach to certificates of deposit. In *Bellah v. First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974), the Fifth Circuit distinguished *Tcherepnin* and concluded that on the record before it, a certificate of deposit was not a security. In *Safeway Portland Employees Federal Credit Union v. C. H. Wagner & Co., supra*, the Ninth Circuit held that a combination of a certificate of deposit, which it assumed arguendo was not a security, and a "bonus" would come within the Securities Act.

The Seventh Circuit decided that a certificate representing a currency deposit in a commercial bank, such as that present here, was not a security or investment transaction. *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465, 470 (7th

Cir. 1980). As here, the complaint in *Fingland* failed to include a copy of the document upon which jurisdiction was premised. However, despite the absence of the certificate of deposit, the court was able to distinguish the commercial instrument relied upon there and the investment transaction found in *Tcherepnin.* As the court aptly noted, if *any* document labeled certificate of deposit were a security, "there would no longer be any validity to the distinction between commercial and investment transactions since any depositor in a failed bank could claim the same protection accorded security holders." *Id.*

Taking a different approach, in *SEC v. First American Bank & Trust Co.*, 481 F.2d 673, 678 (8th Cir. 1973), without discussion, the court said that "capital notes, certificates of investment, and passbook savings accounts" in a bank were securities within the scope of the Securities Act. In a footnote, the court referred to the language in the 1933 Act "Any note [or] evidence of indebtedness." The last clause, it must be noted, is not included in the definition in the Securities Exchange Act of 1934, the applicable statute in this case.

Contrary to the implication in the majority opinion, there is a difference between a certificate of deposit issued by a commercial bank and a debt obligation of a corporation in some other line of endeavor. The bank is in the business of borrowing and lending money. With the exception of finance companies and others of that nature, however, corporations generally borrow money to generate capital necessary for costs of operation. Furthermore, bank borrowing and lending activities are closely regulated by designated governmental agencies. Because of this supervision, the need to protect depositors under the Securities Exchange Act is not as apparent as it is with nonbanking entities. This philosophy is also reflected in the many cases that have found bank loans based upon promissory notes not within the scope of the Act; *McClure v. First National Bank of Lubbock, supra* at 492-93: *Bellah v. First National Bank of Hereford, supra.*

The American Law Institute shares this view, for its proposed Federal Securities Code specifically excludes from the definition of security an interest in a deposit account with a bank, and "a bank

certificate of deposit that ranks on a parity with an interest in a deposit account with the bank." ALI FED. SECURITIES CODE, § 299.53(b)(5) (Mar. 15, 1978 Draft). As the Committee comments, "although literally one may find an "evidence of indebtedness" or (when interest is paid) an "investment contract," it seems logical to exclude these interests along with traditional insurance policies and annuity contracts form the definition of "security." The exclusion extends to savings and checking accounts, as well as time and demand deposits, but not to custody accounts. The proposed exemption does not apply to savings and loan associations in recognition of the distinction between *Tcherepnin*-type interests and the usual commercial bank transactions.[4]

Since I would hold that the certificate of deposit was not a security, I need not address the issue of whether a pledge constitutes a sale, a point of conflict between the circuits that may soon be resolved by the Supreme Court. *United States v. Rubin*, 609 F.2d 51 (2d Cir. 1979), *cert. granted*, 48 U.S.L.W. 3662 (1980) (No. 79-1013).

It is obvious I do not share the majority's view that the 1934 Act was intended to cover virtually every transaction in which an investor might expect to receive a return on his money. *See, e.g., Glick v. Campagna*, 613 F.2d 31, 35 n.3 (3d Cir. 1979); *Collins v. Signetics Corp.*, 605 F.2d 110, 113 (3d Cir. 1979). Although the Securities Act should be interpreted liberally to carry out its purposes, we should also heed the admonition in *Woodward v. Metrobank of Dallas*, 522 F.2d 84, 90 (5th Cir. 1975), "The court must ask whether the conduct in a case before it was the type of behavior meant to be forbidden by the Securities Acts, remembering that business transactions are not all reducible to a purchase or sale of a security." Nor should we "convert § 10(b) of the Securities Act into a source of general federal jurisdiction." *Great Western Bank & Trust Co. v. Kotz, supra* at 1253.

4. I realize, of course, that it can be argued that the ALI proposal is an indication that the drafters believe that the bank certificate presently comes within the definition in the Exchange Act. Nevertheless, I am more impressed with the implication in the ALI view that inclusion of bank certificates of deposit within the scope of the Securities Act is unnecessary.

I do not believe that the transactions in the case at hand come within either the spirit or intent of the Securities Exchange Act and accordingly, I dissent.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER and ALICE WEAVER,
Appellants

v.

MARINE BANK

ON APPEAL FROM THE UNITED STATES DISTRICT OFFICE
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

(D.C. Civil No. 79-0066)

Argued: September 18, 1980

Before: GIBBONS, WEIS and SLOVITER, *Circuit Judges*

(Opinion Filed: December 15, 1980

ORDER AMENDING OPINION

The slip opinion in the above matter is hereby amended as follows:

Page 6 n.2, Flush Material, First Line:

"15 U.S.C. § 78C(a)(10)" is amended to read "15 U.S.C. § 78c(a)(10)"

Page 14, Line 7:

"#4.6(382)" is amended to read "§ 4.6(374)"

JOHN J. GIBBONS
Circuit Judge

Dated: January 28, 1981

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER, *Plaintiffs*

v. Civil Action No. 79-66 Erie

MARINE BANK,
Defendant

MEMORANDUM AND ORDER GRANTING MOTION FOR SUMMARY JUDGMENT

The complaint in this case was filed May 4, 1979. In due course, the answer was filed. Thereafter the parties had rather extensive discovery. Interrogatories were filed, and several depositions were taken, particularly of the two plaintiffs, and at least two of the employees of defendant who were involved in this transaction. In accordance with our practice, the case was noticed for pretrial conference. But in the meantime, on December 14, defendant filed a motion to dismiss the complaint or for summary judgment. Accompanying that motion were affidavits of two employees of defendant. On December 18, 1979, plaintiff filed an answer to defendant's motion for summary judgment.

Counsel have been heard at oral argument on the issues raised in the motion for summary judgment. Under Rule 56, it has been conluded that based upon the pleadings, depositions, answers, answers to interrogatories, admissions, and affidavits, it appears certain that there is no genuine issue as to any material fact and that defendant is entitled to judgment as a matter of law on the issue as to whether this Court has subject matter jurisdiction. Counsel for plaintiffs is experienced and able. He knows how to aver jurisdiction in the Federal Courts. But in the first numbered paragraph of the complaint he names the plaintiffs and says, ". . . having a place of residence at R.D. #4, Union City, Erie County, Pennsylvania, 16438," without averring any citizenship with respect to either plaintiff. There is no question but what the bank is a Pennsylvania corporation with its

principal place of business in the City of Erie in this judicial district. But, nevertheless, it appears from matters outside the pleadings that both plaintiffs are as a matter of fact citizens of Pennsylvania with the result that there can be no jurisdiction in this case under the diversity statute. Thus the only jurisdiction in this Court as averred in the complaint must be premised upon the Securities and Exchange Act, 15 U.S.C.A. 78 (aa), and its amendments and the rules of the Securities and Exchange Commission. The point is, however, that plaintiffs say they purchased a security in the Columbus Packing Company which is within the definition of "security" as that term is defined in 15 U.S.C.A. 78 (c)(a)(10). Defendant, of course, denies that there was any security involved in the transaction between these parties and as alleged in the complaint.

A careful examination of the issues as revealed in all the documents in this case has satisfied me that the defendant is correct in its contention. In the first place, plaintiffs say in an affidavit attached to their answer to the motion that on February 28, 1978, they were co-owners of a $50,000 certificate of deposit, which had been purchased at the Corry office of the Marine Bank. The reason for the purchase, they said, was "... for purposes of having money available for the operation of our livestock auction . . ." in the Union City, Pennsylvania, area. Attached to the complaint is a document executed by the Weavers in which it is recited that Columbus Packing Company, hereinafter "Piccirillo", was about to enter into an agreement with Marine Bank for a loan of $50,000, and the Weavers in the document agreed to become co-obligors on a loan to be extended by the Marine Bank to Piccirillo. But this instrument defined the rights of the Weavers in the Piccirillo operation. For instance, Weavers had the right to use the barn and pastures on the Columbus Packing Company premises. They were to receive 50% of the profits, and they were to receive $100 per month salary until such a time as the obligation was paid in full by Piccirillo. It is certain that this document was not known to anyone in the bank at the time of the transaction complained of by the plaintiffs in this case. (See Weavers' depositions.)

In the complaint plaintiffs' counsel says the document just recited, Exhibit A, was the purchase by plaintiffs of a security transaction. Complaint, Para. 7. The remaining paragraphs of the complaint

generally speaking aver deception on the part of the bank with respect to the disposition of the $50,000 certificate of deposit, which was hypothecated by the Weavers as security for the loan. General fraud is alleged on the part of the bank employees to induce Weavers to secure the loan by the $50,000 deposit. But in the answer to defendant's motion for summary judgment, counsel for plaintiffs indicates in paragraph 2, that plaintiffs purchased a second security on March 17, 1978, in connection with the transaction. In any event, in the answer to the motion it is contended that there are genuine issues of material facts as to whether the defendant, Marine Bank, violated Section 10(b)5 of the 1934 Securities and Exchange Act and Section 17(a) of the 1933 statute," . . . in connection with the purchase and sale of the aforementioned securities, causing the Weavers' at least $50,000 in damage . . ."

The forerunner to the bank loan was the agreement between Piccirillo and Weavers that the latter would become co-obligors on the proposed bank loan. It is inherent in this instrument that these people knew that Weavers had $50,000 to back up the obligation to the bank. Counsel for Weavers claims this was a security transaction within the meaning of the statute. I disagree. In this deal, Weavers simply become co-obligors on the bank note for a consideration. The latter being the rights retained by them including the salary.

As the Court reads counsel's brief and answers, there is some confusion with respect to the certificate of deposit. Counsel says this was the purchase of a second security, but that was in existence prior to any transaction between the Weavers and the bank. They say they owned the certificate on February 28, 1978. It is certain that all the other documents were executed on March 17, 1978, and that the deposit was to secure the bank for the loan mentioned in their agreement with Piccirillo. The bank deposit cannot be considered a security. In the complaint generally, aside from whether the transaction was a security transaction, plaintiffs aver a general cause of action for relief from the bank based on issues which are generally determined under the diversity jurisdiction. These issues are raised in Counts 2 and 3 of the complaint with the averment that they are under the pendent jurisdiction of the Court. But see Judge Hunter's opinion,

Lentino and Flame v. Fringe Employee Plans, Inc., No. 78-1110, decided December 18, 1979. No diversity jurisdiction is averred in this case.

Mr. Conner, for plaintiff, is attempting to make a federal case out of this situation. But this Court can find no subject matter jurisdiction under the statute involved. Thus the alleged pendent jurisdiction fails. Certainly the issues raised show that the transaction was nothing more than an ordinary commercial transaction entered into by borrowers and co-obligors such as Weavers with security given the lender by one of the co-obligors, that is, the Weavers, plaintiffs in this case. As indicated, the briefs have been considered. This is an issue which has been reviewed by a host of district courts and courts of appeal with respect to a transaction of this kind. I have concluded that the brief of defendant covers the facts and the law of this case. I find no genuine issue as to any material facts with respect to the lack of jurisdiction in this Court under the statute. The defendant's brief explains my reasons for the decision in this case. It is comprehensive and authoritative. It is annexed hereto as Appendix A and made a part of this memorandum.

The motion for judgment is granted.

JUDGMENT ORDER

AND NOW, January 11, 1980, pursuant to Rule 56, based upon the pleadings, depositions, answers to interrogatories, admissions, affidavits, and all other documents in this case and upon consideration of the oral arguments of counsel and their briefs; this Court is satisfied that there is no genuine issue as to any material fact, and, therefore, defendant is entitled to judgment as a matter of law. Defendant's motion for summary judgment is granted. Judgment is Directed to be entered for defendant, Marine Bank, and against the plaintiffs, and this civil action is dismissed.

IT IS SO ORDERED.

JOSEPH P. WILLSON,
Senior District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER

v. Civil Action No. 79-66 Erie

MARINE BANK

ORDER CORRECTING ERROR

AND NOW, January 28, 1980, counsel for defendant, Marine Bank, by letter called my attention to the inadvertent error with respect to Appendix "A" attached to my Memorandum and Order for Judgment filed January 11, 1980. In that Order pursuant to Rule 56, defendant's motion for summary judgment was granted. In the last page of the Memorandum, I stated in part:

> "The defendant's brief explains my reasons for the decision in this case. It is comprehensive and authoritative. It is annexed hereto as Appendix A and made a part of htis memorandum."

However, rather than the brief of the defendant filed by McClure, Dart, Miller, Kelleher & White, Esquires, attorneys for defendant, plaintiff's brief filed by Dunn and Conner, Esquires, was attached. This is an obvious error, and Appendix "A" attached to my Memorandum of January 11, 1980, is deleted and set aside; and attached hereto and made a part of my decision in this case is defendant's brief marked Appendix "B".

IT IS SO ORDERED.

JOSEPH P. WILLSON,
Senior District Judge

(APPENDIX "B" TO JUDGE WILLSON'S OPINION)

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER

v. **Civil Action No. 79-66 Erie**

MARINE BANK

BRIEF OF MARINE BANK IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

I. STATEMENT OF FACTS

On or about March 17, 1978, Marine Bank entered into a loan with Columbus Packing Company, a proprietorship owned by Raymond A. Piccirillo, Jr. and his wife, Barbara J. Piccirillo. (Affidavit Santom, par. 1 and Exhibit D thereto). This note was co-signed by Raymond A. Piccirillo, Sr. and Mary T. Piccirillo (Affidavit Santom, par. 4 and Exhibit D thereto). As additional security for the loan the plaintiffs, Sam (a/k/a Ezra) and Alice Weaver signed an agreement of guaranty and pledged a $50,000.00 certificate of deposit as collateral. (Complaint, par. 8; Complaint Exhibit B). Some time prior to March 17, 1978, the Piccirillos and the Weavers entered into an "Agreement" under which Weavers were to receive 50% of the "adjusted net profits" of Columbus Packing Company along with other financial arrangements. (Complaint, par. 7; Complaint Exhibit A). The Marine Bank was not informed of this "Agreement" and knew nothing about it. (Affidavit Santom, par. 5-8; Affidavit Daggett, par. 3-6; Depo. E. Weaver, p. 29 and p. 52; Depo. A. Weaver, p. 60-61).

Columbus Packing Company filed a Petition in Bankruptcy on or about July 21, 1978 and has been adjudicated a bankrupt. (Complaint, par. 16).

Plaintiffs instituted the above action, alleging a violation of the anti-fraud provision of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. 240.10b-5 alleging the Bank employed manipulative and deceptive devices to induce them to enter into the Agreement attached to the complaint as Exhibit A.[1]

II. ARGUMENT

A. The guarantee of the plaintiffs of the payment of note to Marine Bank dated March 17, 1978 is not a "security" as defined in the Securities Exchange Act of 1934, 48 stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's rule 10b-5, 17 C.F.R. 240.10b-5.

Plaintiffs have alleged a violation of the anti-fraud provisions of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10b-5. These sections generally prohibit engaging in fraud in connection with the purchase or sale of a security. It is the position of the Marine Bank that an essential element of the alleged offense is the purchase or sale of a "security" and that, in the instant case, there has been no purchase or sale of a security.

Plaintiffs acted as guarantors of a loan by Marine Bank to Raymond A. and Barbara J. Piccirillo, d/b/a/ Columbus Packing Company. The note was dated March 17, 1978 in the amount of $65,000.00 and was co-signed by Raymond A. and Mary T. Piccirillo, Sr., the parents of Raymond. As guarantors, plaintiffs signed a guaranty agreement and hypothecated a $50,000.00 certificate of deposit as collateral. This constituted the entire transaction between the plaintiffs and the Bank.

A 10b-5 action cannot be predicated on the guarantee of the note because the note is not a "security" as defined in the 1934 Act. A security is . . .

1. A related case was Raymond A. Piccirillo, Sr. and Mary T. Piccirillo v. Marine Bank (W.D. Pa. NO. 78-85 Erie) in which judgment was entered in favor of defendant on February 8, 1979.

> "unless the context otherwise requires — any note..." Securities and Exchange Act of 1934, 48 Stat. 882, 15 U.S.C. § 78c (a) (10).

Despite the "any note" language of the Act, the Third Circuit is aligned with the Fifth, Seventh, and Tenth Circuits in holding that not every note is a "security".[2] Instead, these Circuits consistently hold that notes executed in ordinary commercial — as opposed to investment — transactions are exempt from the Securities Acts. These decisions are based on the Congressional purpose in enacting securities acts and the statutory preface to the definitional section quoted above as "unless the context otherwise requires". Such case law developed due to a series of lawsuits, like the present, wherein plaintiffs sought to invoke federal jurisdiction over ordinary commercial notes simply because fraud is easier to prove under § 10b-5 than under state statutes and the common law.

One of the seminal cases in this area is strikingly similar to the instant case both legally and factually. In *Bellah v. First National Bank of Hereford, Texas,* 495 F 2d 1109 (5th Cir., 1974), plaintiffs borrowed money from the bank to aid them in development of their livestock business. They executed a note, secured by a mortgage on real property. Later, they also deposited a certificate of deposit in the bank. The plaintiffs claimed the bank misrepresented to them that they "need not worry about foreclosure", just as plaintiffs allege Marine Bank did in the instant case. The District Court dismissed the complaint for lack of jurisdiction and the Fifth Circuit affirmed, stating:

> "The record reveals that in extending the loans, the Bank merely intended to aid the [plaintiffs] in the operation of their livestock business. It is bereft of any evidence that the Bank sought to profit from the successful operation of this enterprise . . . We merely hold that notes issued in the context of a commercial loan transaction fall beyond the purview of the Act." 495 F. 2d 1109 at 1113-1114 (5th Cir., 1974).

2. See "Notes Are Not Always Securities", 30 Business Lawyer 763 (1975).

The practical ramifications of including commercial loans under the 1934 Securities Act were also discussed by the *Bellah* court when it stated:

> "First, in view of the . . . similitude of the '33 and '34 Acts, notes subject to the anti-fraud proscriptions of the latter would be amenable to the registration provisions of the former. Registration is a costly procedure, both temporally and financially speaking. Subjection of loan transactions involving a promissory note to the registration requirements would inevitably *wreak havoc on the commercial paper market* . . . Second, . . . we doubt that Congress intended by these Acts to render federal judges the guardians of all beguiled makers or payees. Where, as here, complaints are spawned by a commercial loan transaction, recourse must be had to state not federal courts. 495 F. 2d 1109 at 1114 (5th Cir., 1974) (emphasis added).

Bellah was decided also in part by reliance on the Third Circuit decision in *Lino v. City Investing Company*, 487 F. 2d 689 (3rd Cir., 1973). The plaintiff in *Lino* purchased a franchise sales center license agreement, payment to be made in part by a promissory note. The Third Circuit held on a motion to dismiss that the giving of a personal promissory note is not the "purchase" of a "security" within the meaning of 240 C.F.R. 10 (b) (5). The court relied on three factors, all of which are present in the instant case. These were (1) the alleged fraud arose from a personal promissory note, (2) there was no public offering of the note, and (3) the maker [guarantor] of the note is the person claiming to be defrauded. The court noted that

> "[To] accept [plaintiff's] arguments would mean that any consumer who bought an article 'on time' and issued a note would be able to sue in a federal court on the theory the retailer had purchased his 'security.' If it had intended . . . to extend federal jurisdiction to transactions of this type, Congress most certainly would have given a real indication of such an intent." 487 F. 2d 689 at 695 (3rd Cir., 1973).

The commercial/investment dichotomy was reaffirmed by the United States District Court for the Eastern District of Pa. in *Provident*

National Bank v. Frankford Trust Co., 468 F. Supp. 448 (E.D. Pa., 1979). A participating bank in a loan participation agreement sued the lead bank in that case to recover for alleged 10b-5 violations. Pursuant to a motion to dismiss, the court held the loan participation agreement was neither a "security" nor an "investment contract". The court looked to two important factors. First, the lead bank did not exercise managerial efforts over the project. In the present case, plaintiffs have not alleged that Marine Bank acted in a managerial capacity over Columbus Packing. Secondly, as in the present case, there was no public offering. The lead bank in *Provident*, like Marine Bank, had no entrepeneurial interest in the project in the sense that they would generate the return expected by the parties to the participation agreement. Marine Bank was not involved in the meat slaughtering business but simply made a commercial loan. Any profits were to be generated by the Piccirillos, not Marine Bank . Thus the loan by the Bank was not an investment.

Similar reasoning was applied to the guarantor of a note in *Emisco Industries, Inc. v. Pro's, Inc.*, 543 F. 2d 38 (7th Cir., 1976). In *Emisco*, the plaintiff subsidiary corporation purchased assets of the defendant in part by a promissory note guaranteed by its parent corporation. The parent and the subsidiary brought action under 10b-5, arguing the transaction was investment in nature. The court held the transaction was essentially commercial in nature because the defendant, like the Marine Bank, expected the subsidiary to pay off the note and, if it failed, for the guarantor to pay it off. In other words, the Bank expected to be paid whether the business was successful or not. As stated in *Emisco*,

> "This was the natural expectation (as for any loan), whether or not plaintiffs achieved profits on any of their businesses."

Another case similar to the instant case which has been cited with approval in this Circuit is *McClure v. First National Bank of Lubbock, Texas*, 497 F. 2d 490 (1974). The plaintiff in *McClure* alleged that bank loan officers engaged in fraud to induce her to consent to a loan from the bank to her closed corporation and further defrauded her into pledging her corporate stock as collateral. The bank filed a motion to dismiss. The court held that assuming fraud for the purpose

of review, as it had to, there was no subject matter jurisdiction because there was no purchase or sale of a security. The court relied on two factors. The corporate note, like the Marine Bank note, was not offered to investors. Secondly, like the Marine Bank note, it was not acquired by the bank for speculation or investment. The proceeds of the loan were used so that the corporation could pay off its *business debt*. Thus, the court concluded, the corporation did not obtain investment assets in exchange for its note. This court has already found in a related case that the proceeds of the Marine Bank loan to Columbus Packing were used entirely to pay off business debts. See *Piccirillo v. Marine Bank* , C. A. No. 78-85, Erie (W.D. Pa., 1979). Thus, the note was not an investment contract.

The implications of bringing the present case under the purview of the 1934 act are even clearer if the situation is viewed in reverse. Can a bank sue under 10b-5 any debtor who allegedly misrepresented his or her financial position? Could Marine Bank sue Mr. Piccirillo or Mr. Weaver under 10b-5? This was the situation in *Tri-County State Bank v. Hertz*, 418 F. Supp. 332 (M.D. Pa., 1976), where the bank sued a debtor corporation under 10b-5, stating the corporation misrepresented its financial position. The court, relying on *Bellah, Lino* and the *McClure* cases, held the bank had received commercial paper and not investment securities. The following elements were present: (1) the note was a demand note and could be called in at the first sign of insolvency (like the Marine Bank note); (2) the proceeds of the loan were used to pay business debts and not for capital expenditure or by the use of any entity than the debtor (like the proceeds of the Marine Bank note); (3) the loans arose out of an already existing customer relation and the impetus for the loan came from the debtor who sought working capital (like the Marine Bank loan); (4) the note was on the bank's standard promissory note form (like the Marine note form); (5) the loan was secured (the Marine loan was also); (6) the Bank expected to be paid regardless of the success of the business (as did Marine); and (7) the interest to be paid the Bank was at a fixed rate and did not depend on the profitability of the debtor's business. The court made it clear that although the bank did not realize a full return because of default, that did *not* mean the bank invested risk capital, stating "The 'risky loan' must be extinguished from an investment of 'risk capital'". 418 F. Supp. 332 at 343 (M.D. Pa., 1976).

Finally, the commercial/investment dichotomy has been sanctioned by the United States Supreme Court, which has cited *McClure* and *Lino* with approval. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 44 L. Ed. 2d 621, 95 S. Ct. 2051 (1975).

It is therefore well established that the securities laws are not designed to afford general relief to debtor, guarantor or creditor when commercial loans turn out to have been unwisely made, nor are they a source of general federal jurisdiction. When a transaction is commercial in nature, it is outside the purview of the 1934 Act. For other cases in accord, see: *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.*, 508 F. 2d 1354 (7th Cir., 1975) [motion to dismiss granted when bank loaned business funds secured by a chattel mortgage; nothing in complaint indicated bank invested in or was a co-partner in the enterprise]; *Joseph v. Norman's Health Club, Inc.*, 336 F. Supp. 307 (E.D. Miss., 1971) [promissory note executed in exchange for a lifetime membership in a health club not a security under 10b-5 when debtors allege failure to disclose failing financial condition of club]; *S.E.C. v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 (S. D. N.Y., 1968) [loans by corporation to corporate officers to pay personal obligations fraudulent but not "securities" within the meaning of 10b-5]; *United Sportsfishers v. Buffo*, 396 F. Supp. 310 (D.C. Calif., 1975) [promissory note secured by a second ship's mortgage in a commercial financing venture not a security within the ambit of the securities laws]; *Amfac Mtg. Corp. v. Arizona Mall of Tempe*, 583 F. 2d 426 (9th Cir., 1978) [note given a lender in the course of commercial financing is not a security]; *Avenue State Bank v. Tourtelot*, 379 F. Supp. 250 (N.D. Ill., 1974) [bank loan to defendant who misrepresented its financial picture not a "security"]; *Lincoln National Bank v. Lampe*, 414 F. Supp. 1270 (N.D. Ill., 1976) [bank loan to debtor on basis of five promissory notes and secured by stock certificates later found to be worthless outside purview of 1934 Act].

B. *The guarantee of the plaintiffs of the payment of note to Marine Bank is not "in connection with" the purchase or sale of a security as defined in the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78; (b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. 240.10b-5.*

In their complaint, plaintiffs further predicate their 10b-5 action upon a document attached as Exhibit "A" titled "Agreement" (hereinafter "Agreement"). Yet, on its face, this "Agreement" purports to be some sort of side arrangement between Raymond A. Piccirillo, Jr., Barbara G. Piccirillo, Samuel Weaver and Alice F. Weaver. The Marine Bank is not a party or witness to this Agreement. It is the position of the Bank that if, in fact, this Agreement could constitute a "security" as defined in the 1934 Act, there is no connection as matter of law between the Bank and this Agreement on which to base 10b-5 liability.

Along with the requirement that a "security" exist, the second basic element of 10b-5 liability is that any alleged fraud must be "in connection with" the purchase or sale of any security. 15 U.S.C. § 78 j (b); 17 C.F.R. 240. 10b-5. The "in connection with" language means there must be a showing of causation between the alleged fraud and the plaintiff's purchase or sale of a security. *Ketchum v. Green,* 415 F. Supp. 1367 (W.D. Pa., 1976).

A case has been decided which is virtually identical to the facts in this case. In *Woodward v. Metro Bank of Dallas,* 522 F. 2d 84 (5th Cir., 1975), the court dismissed a 10b-5 action against the bank for lack of jurisdiction for failure to satisfy the "in connection with" language of the Act. an analysis of the facts in *Woodward* is important because it parallels the facts in the instant case so closely.

In *Woodward,* the president and controlling shareholder of a corporation which eventually went bankrupt requested the plaintiff to co-sign a note at the defendant bank. In return for this assistance, the corporation president promised to pay plaintiff $1,250.00 per month during the life of the note. The plaintiff co-signed the note, pledging her stock and a $50,000.00 C.D. as security. Later, plaintiff signed a renewal note at the same bank. The corporation defaulted, the bank liquidated the C.D. and began to foreclose on the stock. Plaintiff sued the bank, the bank loan officer and the corporation president under 10b-5.

As against the bank, plaintiff first argued that the note she co-signed was a "security". The court rejected this argument under the analysis set forth in Part A of this brief.

Secondly, plaintiff relied upon the agreement with the corporation president for $1,250.00 per month, alleging this was an investment contract. She alleged that the Bank failed to disclose to her the precarious financial position of the corporation, including frequent N.S.F. occurrences, that the corporation had other loans outstanding at the bank, that the loan proceeds would go to the president personally and not as working capital, that the bank benefited from the proceeds of the renewal note, that at the time of renewal the corporation had changed banks and that in co-signing the note, plaintiff was obligating herself to repay other outstanding loans at the bank of which she had no knowledge. These are very similar, albeit more sinister, charges to those in the instant case.

Since in *Woodward* the plaintiff did not loan money to the corporation but rather loaned credit and stock as collateral, the court had to analyze whether the bank was a proper party to the action. Like the "Agreement" attached to the Weaver complaint, the alleged investment contract was between plaintiff and the corporation president. It was not alleged, as it is not here, that the plaintiff invested in the bank or that the bank was investing in the company. Thus, to be liable at all, *the bank had to be vulnerable under the secondary liability theory of aiding and abetting.*

The court then analyzed the various elements necessary for liability as an aider and abettor. The elements under the test used in the Third Circuit are set forth in *Landy v. F.D.I.C.*, 486 F. 2d 139 (3rd Cir., 1973) and are: (1) the existence of an independent wrong; (2) *knowledge* on the part of the alleged aider and abettor of the wrong's existence, and (3) substantial assistance in effecting the wrong. 486 F. 2d 139 at 162-3.

The *Woodward* court concluded that the bank lacked the requisite knowledge to be held as an aider and abettor. The lack of disclosure by the bank was characterized as "sharp dealing, perhaps, but not a 10b-5 violation", mainly because the Texas Uniform Commercial Code contained no duty to disclose to an accommodation maker the financial condition of the primary obligor. 522 F. 2d 84 at 99. Thus the grant of the bank's motion to dismiss was affirmed.

An analysis of the facts in the present case lead to the same conclusion. Since the "Agreement" relied on the plaintiffs is clearly between the Piccirillos and the Weavers, the liability of Marine must be predicated upon the theory of aiding and abetting. Applying the Third Circuit test in *Landy v. F.D.I.C.*, the court must first find an independent wrong. If such a wrong exists, it exists in the relationship between Piccirillos and the Weavers. Secondly, and most importantly, the Bank must have *knowledge* of the wrong and substantially assist in its effect. In reading the depositions and affidavits in this case, it is uncontradicted that the Bank did not know of either the existence of or contents of the "Agreement" which is alleged to be the investment contract. The story surrounding the "Agreement" emerges as follows. The "Agreement" was suggested by Raymond Piccirillo, Jr. to Mr. Weaver. Piccirillo offered Weaver a "little share of the business". (Depo. E. Weaver, p. 24-5). The written agreement was prepared by Piccirillo's attorney. (Depo. E. Weaver, p. 31). The document was delivered by Piccirillo and his wife to the Weaver home, where the four of them negotiated certain changes and signed it. (Depo. E. Weaver, p. 51-52). Mr. Weaver kept a copy of the agreement. (Depo. E. Weaver, p. 52). To satisfy the test of *Landy v. F.D.I.C.*, the bank must have *knowledge* of the agreement. The record is clear that it did not. When asked if he ever told the bank of this "side" agreement, Weaver responded:

> "No; they never knew about that agreement, that I know of. I never told them. In fact, I never was to the bank from the time I loaned the money, put the money in the C.D. . . ." Depo. E. Weaver, p. 29).

Again:

> Q. - "Did you ever tell Mr. Dagget or Mr. Santom about that "Agreement?"
>
> E. Weaver - "No." (Depo. E. Weaver, p. 52).

Identical testimony was offered by Alice Weaver, his wife:

> Q. - "Did you tell Mr. Santom about the agreement with Mr. Piccirillo?"
>
> A. Weaver - "No."

Q. - "Is there any reason why you didn't tell him about it?"

A. Weaver - "No."

Q. - "You had the original of this in your possession, isn't that correct?"

A. Weaver - "That's right."

Q. - "But you didn't bring it with you to show it to the Marine Bank at all?"

A. Weaver - "No." (Depo. A. Weaver, p. 60-61).

Thus the test set forth in *Landy v. F.D.I.C.*, 486 F. 2d 139 at 162-3 has not been met.

The complaint alleges that the "deceptive and manipulative devises" used by Marine Bank consisted in the failure to disclose the financial details of Columbus Packing. Assuming for purposes of this motion that the Bank did not so inform the Weavers, this does not violate 10b-5. In the absence of a duty to disclose, the Bank's alleged silence cannot be construed to be aiding and abetting the purchase of a security of which it had no knowledge. In *Landy*, plaintiffs alleged certain brokerage firms failed to disclose to them a fraud perpetrated by the president of the company in which plaintiff's purchased securities. The court found that since the brokers did not know plaintiffs were purchasing shares at the time and, even if they did know, they were under no affirmative obligation to disclose, jurisdiction did not arise under 10b-5. Pennsylvania law dealing with commercial paper imposes no duty on banks to disclose to a guarantor the financial situation of the primary debtor. 12A P.S. 3-416, Pa. U.C.C. § 3-416. As noted in *Woodward*, no significance can be attached to the Bank's requirement of additional collateral, as the *raison d'etre* of a guarantor is to add financial support.

To hold the bank accountable to 10b-5 liability in this case would have the effect of making all banks the insurers of the conduct of their debtors, since any time the debtor was engaged in a fraud and the bank's loan assisted the fraud, the bank would be liable. This type of attempt to extend 10b-5 to encompass anyone who comes at all

in touch with the purchase or sale of security was squarely rejected as to banks in *Woodward* and as to brokers in *Landy*. Business activity is often governed by other laws, as noted in *Woodward*, such as the Uniform Commercial Code, Truth-in-Lending, antitrust and state fraud provisions. However, under these facts, the claim does not fall with the purview of 10b-5.

Respectfully submitted,

Daniel L. R. Miller, Esq.

Christine Hall McClure, Esq.

McCLURE, DART, MILLER,
KELLEHER & WHITE
501 Marine Bank Building
Erie, Pennsylvania 16501
(814) 453-3681

Attorneys for Marine Bank

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and
ALICE WEAVER *Plaintiffs*

v.

Civil Action No. 79-66 Erie

MARINE BANK
Defendant

ORDER ON MOTION

AND NOW, January 31, 1980, the Clerk has called my attention to a motion to amend the complaint filed January 25, 1980. In Paragraph 2, counsel mentions the judgment in favor of the Marine Bank which was entered pursuant to Rule 56. In Paragraph 3, counsel mentions that affidavits and briefs filed by plaintiff in opposition to the motion for summary judgment set forth additional theories of liability, which were not set forth specifically in the complaint initiating this claim. But it is my view that under Rule 15, especilly 15(a) and (c), there is no necessity to amend the complaint, as counsel mentions Rule 56 was applied after reviewing all the pleadings, despositions, affidavits, and briefs filed by the respective parties. Thus, all theories of liability advanced by plaintiff have been considered and will be before the Court of Appeals. Therefore, under the situation presented in the motion, an amendment is unnecessary. The motion to amend is denied.

IT IS SO ORDERED.

JOSEPH P. WILLSON,
Senior District Judge

CC:
Andrew J. Conner, Esq.
Daniel L. R. Miller, Esq.,
and Christine H. McClure, Esq.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

Samuel Weaver and Alice Weaver,
Appellants

v.

Marine Bank

(D. C. Civil No. 79-0066)

On Appeal From The United States District Court
For The Western District Of Pennsylvania

Present: GIBBONS, WEIS and SLOVITER, Circuit Judges

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel on September 18, 1980.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed January 11, 1980, be, and the same is hereby reversed, and the cause is remanded for further proceedings consistent with the opinion of this Court. Costs taxed against appellee.

ATTEST:

Sally Mrvos
Clerk

December 15, 1980

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1274

SAMUEL WEAVER and ALICE WEAVER, *Appellants*

v.

MARINE BANK

(D.C. Civil No. 79-0066)

Before: GIBBONS, WEIS and SLOVITER, *Circuit Judges*

Upon the consideration of the petition for rehearing by petitioner before the original panel,

It is ORDERED that the petition for rehearing before the original panel is denied.

By the Court

JOHN J. GIBBONS
Circuit Judge

January 26, 1981

Office-Supreme Court, U.S.
FILED
JUL 28 1981
ALEXANDER L. STEVAS,
CLERK

No. 80-1562

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK
Petitioner

v.

SAMUEL WEAVER and ALICE WEAVER
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

JOINT APPENDIX

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Counsel for Respondent

PETITION FOR CERTIORARI
FILED MARCH 13, 1981
CERTIORARI GRANTED JUNE 1, 1981

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DOCKET ENTRIES

Samuel Weaver and Alice Weaver v. Marine Bank

Date 1979	Proceedings
May 4	COMPLAINT filed at C.A. 76-66
May 4	Summons issued.
May 7	USM-285 returned served 5-7-79 on Marine Bank.
May 17	Notice of serving interrogatories 1-4 on or about 5-17-79 filed by Pltf.
June 6	ANSWER filed.
June 11	Notice of Depositions of Robert Santom and John Daggett on 7-3-79 at 10:00 a.m.
June 18	Pltfs. Request for production of Documents.
July 5	Pltf's. interrogatories to the Deft, filed with answers.
July 9	Notice of Depositions of Samuel Weaver & Alice Weaver on 8/10/79 filed by Deft.
July 30	Depositions of John Daggett & Robert Santom taken on 7/3/79 at 10:00 a.m. before Evelyn Flowers, Crt Rptr.
Aug. 15	Notice of Pltf's. service of supplemental interrogatory No. 5 on Deft.
Aug. 16	Notice of taking depositions of Will Schulte and C. Conrad Monroe on 8/30/79 at 1:30 p.m.
Aug. 20	Depositions of Ezra M. (Samuel) Weaver and Alice F. Weaver taken on 8/10/79 at 9 a.m. filed by Mary Hines, Crt. Rept.
Aug. 29	Supplemental Interrog's. to Marine Bank filed with Answers.
Sep. 11	Deposition of Wilbur Schuldt & C. Conrad Monroe taken 9/6/79, filed by Mary Hines, Crt. Rept.
Sep. 17	Notice invoking Local Rule 5(II).

Oct. 3	Pltf's. amended request for production of documents.
Nov. 30	Notice scheduling pretrial conf. for 12/20/79 at 3:30 p.m. Erie.
Dec. 14	Motion to dismiss the Cmplt or for summary judgment filed by Deft.
Dec. 14	Affidavits of Robert E. Santom & John J. Daggett filed.
Dec. 18	Pltf's. answer to Deft's. motion for summary judgment filed.
Dec. 18	Pltf's. pretrial narrative statement filed.
Dec. 19	Pretrial narrative statement of Marine Bank filed.
Dec. 20	Pretrial Conf. held before Willson, J., Gene Zurawsky, Crt. Rept., Memo filed.

1980

Jan. 11	Memorandum & Judgment Order granting deft's. motion for summary judgment ent. by Willson, J. Defendant's motion for summary judgment is granted and judgment is directed to be entered for deft. Marine Bank and against the pltfs, and this case is dismissed.
Jan. 11	Judgment on decision of the Court filed by the Clerk entering judgment in favor of deft. and against the plaintiffs Samuel Weaver and Alice Weaver.
Jan. 11	Pursuant to Memorandum & order ent. by the Court & judgment on decision of the Court filed by the Clerk, the within case is hereby dismissed. GILBERT W. CONLEY, CLERK.
Jan. 11	Card notices mailed.
Jan. 25	Pltf's motion to amend cmplt filed.
Jan. 28	Order ent. Willson, J. correcting error with respect to Appendix "A" attached to memorandum & Order ent.

	1/11/80. Appendix "A" is deleted and set aside; and attached hereto and made a part of the decision is deft's brief marked Appendix "B".
Jan. 31	Order ent. Willson, J. DENYING Pltf's motion to amend cmplt.
Feb. 5	Notice of appeal filed by Pltfs.
Feb. 6	Certified copy of notice of appeal, docket, and letter sent to Mr. Quinn, Crt. of Appeals. Notice of appeal & letters sent to all counsel of record.
Feb. 25	Case docketed in United Court of Appeals for the Third Circuit at No. 80-1274; record on appeal filed.
Sept. 18	Argument before U.S. Court of Appeals for the Third Circuit.
Dec. 15	Opinion and judgment reversing judgment of the District Court.

1981

Jan. 26	Order ent. John J. Gibbons, Circuit Judge, ordering that the petition for rehearing before the original panel is denied.
Jan. 26	Order ent. John J. Gibbons, Judge, ordering that the pet. for rehearing by the court in banc is denied. Judges Weis and Garth would grant rehearing.
Mar. 13	Petition for a writ of certiorari docketed in Supreme Court of the United States as No. 80-1562.
June 1	Petition for a writ of certiorari granted.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SAMUEL WEAVER and

ALICE WEAVER

vs. Civil Action No. 79-66 Erie

MARINE BANK

COMPLAINT

AND NOW, come the plaintiffs, Samuel Weaver and Alice Weaver, by their counsel, Andrew J. Conner, Esquire, of DUNN & CONNER, of 1111 G. Daniel Baldwin Building, Erie, Pennsylvania, 16501, and bring this Complaint against the above-named defendant, alleging as follows:

1. The plaintiffs, Samuel Weaver and Alice Weaver, are individuals, having a place of residence at R.D. #4, Union City, Erie County, Pennsylvania, 16438.

2. The Marine Bank is a bank organized under the banking laws of the Commonwealth of Pennsylvania, having its principal place of business at 901 State Street, Erie, Pennsylvania, 16501.

3. Jurisdiction for the claims set forth in this Complaint, in this Court, is premised upon the Securities and Exchange Act, 15 U.S.C.A. 78(a)(a).

4. Telephone calls and the United States Mail were used by Marine Bank in soliciting and inducing the sale of the security involved in this claim and the consummation of the sale had an impact on the bank collections system to the extent that Interstate Commerce was affected and involved in these transactions.

COUNT ONE

5. This Count is brought pursuant to the Securities and Exchange Act, 15 U.S.C.A. 78 (j)(b), 17 C.F.R. 240.10B-5.

6. It is alleged and asserted that on or about March 17, 1978, the plaintiffs purchased a "security" in the Columbus Packing Company, as the term "security" is defined under the Securities and Exchange Acts of 1933 and 1934 and specifically within the definition of "security" as that

term is defined in 15 U.S.C.A. 78 (c)(a)(10).

7. It is alleged and asserted that on or about March 17, 1978, the Weavers were the purchasers of a security in a proprietorship known as Raymond Piccirillo, Jr., d/b/a Columbus Packing Company, hereinafter referred to as "Columbus Packing Company", which allowed the Weavers to receive 50% of the adjusted net profits of the Columbus Packing Company at the conclusion of each fiscal year. A true and correct copy of the document confirming the Weavers' acquisition of this security is attached to this Complaint and designated Complaint Exhibit "A".

8. It is alleged and asserted that on and prior to March 17, 1978, agents and employees of the Marine Bank, including, but not limited to, Robert Santom and John Daggett, acting within the scope of authority given to them by the bank, solicited and induced the Weavers to purchase the aforementioned Columbus Packing Company security, in consideration for which the Weavers hypothecated a $50,000.00 certificate of deposit as collateral security for a loan of $50,000.00 by Marine Bank to Columbus Packing Company and executed an agreement of guaranty limited to $50,000.00 guaranteeing the repayment of Columbus Packing Company's obligations of Marine Bank. True and correct copies of the hypothecation and guaranty agreements referred to in this paragraph are attached to this Complaint and designated Complaint Exhibit "B" and Complaint Exhibit "C", respectively.

9. It is alleged and asserted that agents and employees of Marine Bank on a number of occasions went to the Weavers' home in order to persuade them to invest in Columbus Packing Company.

10. It is alleged and asserted that at all material times prior to March 17, 1978, the agents and employees of Marine Bank responsible for soliciting and inducing the Weavers' purchase of the Columbus Packing Company security in exchange for the pledge of the $50,000.00 certificate of deposit and the $50,000.00 guaranty, knew that the Columbus Packing Company was in serious financial problems. It is alleged and asserted that these agents knew at least the following:

(a) That Columbus Packing Company was indebted to the Marine Bank in an amount in excess of $30,000.00 on notes which were past due;

(b) That Columbus Packing Company had issued checks upon checking accounts at the Marine Bank for which there were not sufficient funds to cover;

(c) That the Internal Revenue Service had imposed liens upon the Columbus Packing Company and its principals, for past taxes;

(d) That there were numerous creditors, who had claims against Columbus Packing Company for material and / or services rendered on and prior to March of 1978.

11. It is alleged and asserted that on and prior to March 17, 1978, and for the purpose of soliciting and inducing the sale of the security to the Weavers, described above, agents for the Marine Bank, acting within the scope of authority given to them by the bank, employed manipulative and deceptive devices in contravention of 15 U.S.C.A. 78(j) and the rules and regulations of the Securities and Exchange Commission to induce the Weavers to purchase the security identified above.

12. It is alleged and asserted that the manipulative and deceptive devices and practices identified in the previous paragraphs of this Complaint included, but are not limited to, the following:

(a) The failure of Marine Bank to advise the Weavers of the amount of the notes owed by Columbus Packing Company to the Marine Bank;

(b) The failure to disclose that the notes, identified in the previous sub-section of this paragraph at Marine Bank were past due;

(c) That the Columbus Packing Company had substantially overdrawn its checking account;

(d) That the Internal Revenue Service was owed substantial money and had filed, or threatened to file, liens against the Columbus Packing Company.

(e) That there were numerous other creditors of Columbus Packing Company, who had claims against the assets of Columbus Packing Company.

13. Contrary to the provisions of 15 U.S.C.A. 78(j) and the rules and regulations of the Securities Commission, the Marine Bank agents and employees responsible for soliciting and inducing the Weavers' purchase of the security identified in the previous paragraphs of this security identified in the previous paragraphs of this Complaint represented to the Weavers the following:

(a) That the Columbus Packing Company was solvent;

(b) That Marine Bank had sufficient and substantial collateral within its control to protect the Weavers from any loss resulting from their execution of the guaranty and the pledge of the certificate of

deposit, identified above;

(c) That the $50,000.00 proceeds from the loan to Columbus Packing Company secured by the Weavers' $50,000.00 certificate of deposit would be used by Columbus Packing Company as "working capital" and not for the purpose of paying creditors, who then had claims against Columbus Packing Company.

14. It is alleged and asserted that in fact the following was true and correct:

(a) The Columbus Packing Company was not solvent;

(b) That there was not sufficient collateral within the control of the Marine Bank to protect the Weavers in the event Columbus Packing Company was liquidated;

(c) That most of the funds generated by the loan were intended, at all times, to be used to pay off creditors of Columbus Packing Company, including, but not limited to, the notes of the Marine Bank, the indebtedness created by the overdrawn checking account and the liens of the Internal Revenue Service, all of which were identified above, and that the funds were actually so applied.

15. It is alleged and asserted that the Weavers purchased the security in the Columbus Packing Company, identified above, in reliance upon the representations made by Marine Bank with respect to the condition of Columbus Packing Company and the use of the funds, described above.

16. It is alleged and asserted that on or about July 21, 1978, Columbus Packing Company filed a Petition for Bankruptcy in the United States District Court for the Western District of Pennsylvania, and was adjudicated a bankrupt.

17. It is alleged and asserted that Marine Bank was listed as a creditor in the amount of $74,000.00 on the bankruptcy schedules of Columbus Packing Company.

18. It is alleged and asserted that to date Marine Bank has received $5,076.96 from the bankruptcy trustees toward its claim against Columbus Packing Company, as the result of the sale of bankrupt's realty which was subjected to a judgment held by Marine Bank and that Marine Bank will receive no further distributions from the bankruptcy Court because:

(a) Its security interest in Columbus Packing Company's personalty was unperfected at the time of the filing of the bankruptcy petition;

(b) It has not filed a proof of claim and the time limit for same has

expired;

(c) Priority claims and costs of administration will, in all probability, exchaust the assets of the bankrupt.

19. It is alleged and asserted that the current balance of principal and interest on the Columbus Packing Company's obligations to Marine Bank exceeds $66,000.00.

20. It is alleged and asserted that Columbus Packing Company's co-maker on the $50,000.00 note, Mr. and Mrs. Raymond Piccirillo, Sr., have a net worth of not more than $35,000.00 and that a deficiency balance on Columbus Packing Company's obligations to Marine Bank will remain following the exhaustion of the co-maker's assets.

21. It is alleged and asserted that Marine Bank will apply the Weavers' hypothecated $50,000.00 certificate of deposit to the extent necessary to satisfy any deficiency balance remaining on the Columbus Packing Company obligations.

22. It is alleged and asserted that the Weavers have, on more than one occasion, requested Marine Bank to rescind the transaction set out in the preceding paragraphs so as to void the hypothecation and guaranty agreements that they have executed and that Marine Bank has refused to consent to a rescission.

23. Plaintiffs claim interest, costs and counsel fees as the law may provide.

WHEREFORE, plaintiffs request that the above described securities transaction be rescinded or that damages in an amount in excess of $10,000.00 with interest and costs and counsel fees be awarded in their favor.

COUNT TWO

24. Plaintiffs incorporate into this Count all of the preceding paragraphs of this Complaint, as if they had been set forth in full.

25. Jurisdiction for the claim set forth in this Count, in this Court, is pendent upon the Court having jurisdiction over the matters set forth in Count One.

26. This Count is brought pursuant to the Pennsylvania Securities Act of 1972, 70 P.S. 31, et al.

27. The security identified in the previous paragraphs of this Complaint, as evidenced by Complaint Exhibit "A", constitutes a "security" under the Pennsylvania Securities Act, as the term "security" is defined by 70 P.S. 1-102(t).

28. That in the context of the securities transaction set out in Count One, Columbus Packing Company is an "issuer" as the term "issuer" is defined in 70 P.S. 1-102(1).

29. That in the context of the securities transaction set out in Count One, the agents and employees of Marine Bank who, acting within the scope of their authority were responsible for persuading the Weavers to invest in Columbus Packing Company, were "agents" as the term "agent" is defined in 70 P.S. 1-102(c).

30. It is alleged and asserted that the agents and employees of Marine Bank involved in this securities transaction have violated the securities registration requirements of the Pennsylvania Securities Act as set out in 70 P.S. 1-201 to 1-209 and that the Weavers are entitled to a rescission under 70 P.S. 1-502.

31. It is alleged and asserted that the agents and employees of Marine Bank involved in this securities transaction are not registered as agents as required by the Pennsylvania Securities Act, 70 P.S. 1-301, and that the Weavers are entitled to damages as set out in 70 P.S. 1-501(a).

32. Plaintiffs claim interest, costs of suit and counsel fees incurred in bringing the within claim.

WHEREFORE, plaintiffs demand a rescission of the above described securities transaction or judgment for damages in an amount in excess of $10,000.00 with interest and costs to be awarded in their favor.

COUNT THREE

33. Plaintiffs incorporate into this Count all of the preceding paragraphs of this Complaint, as if they had been set forth in full.

34. Jurisdiction for the claim set forth in this Count, in this Court, is pendent upon the Court having jurisdiction over the matters set forth in Count One.

35. It is alleged and asserted that the preceding paragraphs set out a cause of action against Marine Bank under the common law of fraud and misrepresentation.

36. Plaintiffs claim interest, costs of suit and counsel fees incurred in bringing the within claim.

WHEREFORE, plaintiffs demand a rescission of the above described securities transaction or judgment for damages in amount in excess of $10,000.00 with interest and costs to be awarded in their favor.

JURY TRIAL DEMANDED

Respectfully submitted,
DUNN & CONNER

By: /s/
Andrew J. Conner, Esquire
Attorneys for plaintiffs,
Samuel Weaver and Alice Weaver
1111 G. Daniel Baldwin Building
Erie, Pennsylvania 16501
A.C. 814-453-6011

Dated: May 4, 1979

AGREEMENT

THIS AGREEMENT made this day of , 1978, between RAYMOND A. PICCIRILLO, JR., and BARBARA J. PICCIRILLO, his wife, t/d/b/a COLUMBUS PACKING COMPANY, (hereinafter "Piccirillo"),

AND

SAMUEL WEAVER and ALICE F. WEAVER, his wife, (hereinafter "Weaver").

WHEREAS, Piccirillo is about to enter into an agreement with Marine Bank for a loan of $50,000.00; and,

WHEREAS, Weaver has agreed, for valuable consideration, to act as a co-obligor on said indebtedness; and,

WHEREAS, it is desirable to set forth the terms under which Weaver has agreed to act as co-obligor.

NOW THEREFORE, in consideration of the mutual covenants herein contained, the parties agree as follows:

1. Weaver agrees to become co-obligor of a loan to be extended by Marine Bank to Piccirillo in the principal amount of $50,000.00, said loan to be closed during March, 1978.

2. While Piccirillo is operating and in possession of the Columbus Packing Company premises and until said $50,000.00 loan is paid in full by Piccirillo, Weaver shall have the following rights:

A. To use the barn and pastures located on the Columbus Packing Company premises in Columbus Township, Warren County, Pennsylvania, at the discretion of Piccirillo.

B. To receive ~~thirty-five (35)~~ 50% RAP & M.W. percent of the "adjusted net profits" of Columbus Packing Company at the conclusion of each fiscal year. The computation of the "adjusted net profits" at the conclusion of each fiscal year shall be based on the percentage of days in the immediately preceding fiscal year during which Weaver was a co-obligor on the aforementioned indebtedness of Piccirillo. By way of example only, if net profits of Columbus Packing Company for a given fiscal year ending December 31st amount to $50,000.00 and Piccirillo's loan obligation to Marine was paid off on September 30 of that fiscal year, Weaver's entitlement would be equal to percent of 75

percent (percentage of days in fiscal year during which co-obligation in effect) of the fiscal year's net profits. The sum arrived at is the "adjusted net profits".

C. Additionally, to receive from Piccirillo the sum of $100.00 per month until such time as the obligation which is the subject of Weaver's co-signature is paid in full.

3. While Piccirillo is operating and in possession of the Columbus Packing Company premises and until the said $50,000.00 loan is repaid in full by him, Piccirillo shall have the obligation to forebear from causing Columbus Packing Company to borrow additional money without prior consultation with and approval by Weaver.

IN WITNESS WHEREOF, the parties have hereunto set their hands and seals the day and year first above written.

/s/ _____ *(SEAL)*
Raymond A. Piccirillo, Jr.

/s/ _____ *(SEAL)*
Barbara J. Piccirillo

/s/ _____ *(SEAL)*
Samuel Weaver

/s/ _____ *(SEAL)*
Alice F. Weaver

[Exhibit "B" of the Complaint, the hypothecation agreement dated March 17, 1978, is reproduced at page JA-24 of this appendix.]

[Exhibit "C" of the Complaint, the guaranty dated March 17, 1978, is reproduced at page JA-26 of this appendix.]

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

[Caption omitted in printing]

ANSWER TO COMPLAINT

AND NOW comes the defendant, Marine Bank, by its counsel, McClure, Dart, Miller, Kelleher & White, of 501 Marine Bank Building, Erie, Pennsylvania 16501, and files the following Answer:

1. Admitted.
2. Admitted.
3. Denied and as further answer, defendant alleges that there exists no statute cited at 15 U.S.C.A. 78(a)(a).
4. Denied.

COUNT ONE

5. Admitted.
6. Denied.
7. Defendant is without knowledge or information sufficient to form a belief as to the truth of the averments contained in paragraph 7, and as a further answer, defendant alleges that neither it nor any of its agents, servants or employees are familiar with or have had any connection with the document attached to plaintiffs' Complaint as Exhibit "A"; however, on its face, said document purports to be contingent upon the Weavers becoming a co-obligor on a note to the Marine Bank, which contingency never occurred.
8. It is denied that on or prior to March 17, 1978, agents and employees of the Marine Bank, including, but not limited to, Robert Santom and John Daggett, acting within the scope of authority given to them by the bank, solicited and induced the Weavers to purchase the alleged Columbus Packing security. It is admitted that the Weavers did hypothecate to Marine Bank a $50,000.00 certificate of deposit as collateral for a consolidated loan by Marine Bank to Columbus Packing, and it is further admitted that the Weavers executed an agreement of guaranty limited to $50,000.00, guaranteeing the repayment of Columbus Packing Company's obligation to Marine Bank. It is admitted that plaintiffs' Exhibits "B" and "C" are true and correct copies of the hypothecation and guaranty agreements.
9. Denied.

10. It is admitted that prior to March 17, 1978, the agents and employees of Marine Bank knew that the Columbus Packing Company was in serious financial difficulty. It is denied that any agent or employee of Marine Bank solicited or induced the purchase of any alleged Columbus Packing security. In specific answer to each subparagraph, the defendant asserts the following:

(a) It is admitted that the Marine Bank knew the Columbus Packing Company was indebted to it in an amount in excess of $30,000.00 on notes which were past due;

(b) It is admitted that Columbus Packing Company had issued checks upon checking accounts at Marine Bank for which there were not sufficient funds to cover;

(c) It is denied that the agents of the Marine Bank knew that the Internal Revenue Service had imposed liens upon Columbus Packing Company and its principals for past due taxes;

(d) It is admitted that there were numerous creditors who had claims against Columbus Packing Company for material and/or services rendered on or prior to March of 1978 and that the agents of Marine Bank knew of same.

11. Denied.

12. (a) It is denied that the Marine Bank failed to advise the Weavers of the amount of the notes owed by Columbus Packing Company to Marine Bank, and in further answer, the defendant alleges that the Weavers were so advised of the amount of said notes;

(b) It is denied that the agents of the Marine Bank failed to disclose that the notes payable to the Marine Bank were past due, and in further answer, defendant alleges that the Weavers were so advised;

(c) It is admitted that the Columbus Packing Company has overdrawn its checking account, and in further answer, defendant alleges that the Weavers were so advised;

(d) It is admitted that the Weavers were not advised by the bank of the Internal Revenue Service liens against Columbus Packing Company, and in further answer, defendant alleges that the bank did not know of said liens;

(e) It is denied that there were numerous other creditors of Columbus Packing Company who had claims against the assets of Columbus Packing Company, and in further answer, defendant alleges that there was only one other creditor to the best of its knowledge which had a claim against the assets of Columbus Packing Company, said

creditor being Penn Bank, which had a lien on a car or truck, and that the Weavers were so advised of said lien.

13. It is denied that the provisions of 15 U.S.C.A. 78(j) and the rules and regulations of the Securities Commission were violated or that the Marine Bank solicited or induced the Weavers to purchase any alleged security, and in further answer, the defendant alleges as follows:

(a) It is denied that the bank, its agents or employees, represented to the Weavers that the Columbus Packing Company was solvent;

(b) It is denied that the agents or employees of the bank represented to the Weavers that there was sufficient and substantial collateral to protect the Weavers from any loss, and in further answer, the bank alleges that were that the case, the bank would not have advised Mr. Piccirillo of the need for additional security;

(c) It is denied that any agent or employee of the bank represented to the Weavers that the loan to Columbus Packing Company would be working capital and not for the purpose of paying creditors who then had claims against Columbus Packing Company, and in further answer, the bank alleges that its agents or employees reviewed with the Weavers a complete breakdown of the distribution of the loan.

14. (a) Admitted.

(b) Denied.

(c) Admitted except for the allegation that the funds generated by the loan would be used to pay the Internal Revenue Service, which is denied.

15. Denied.

16. Admitted.

17. Admitted.

18. It is admitted that the Marine Bank received money from the bankruptcy trustees toward its claim against Columbus Packing Company, said amounts being $5,076.91, and in further answer, defendant alleges;

(a) Denied that the bank's security interest in Columbus Packing's personalty was unperfected at the time of the filing of the bankruptcy petition, and in further answer thereto, the defendant alleges that its security interest was perfected, but in fact was partially preferential due to the date of the filing of the date of the bankruptcy petition;

(b) It is admitted that the bank has not filed a proof of claim and the time limit for same has expired;

(c) Defendant is without knowledge or information sufficient to

form a belief as to the truth of whether priority claims and costs of administration will exhaust the assets of the bankrupt, there being no distribution order at this point form the bankruptcy court, and to the best of the knowledge of Marine Bank, there has been no final meeting of creditors in said bankruptcy.

19. Admitted.

20. Admitted.

21. Admitted.

22. Admitted.

23. Denied.

WHEREFORE, Defendant requests that the Complaint be dismissed.

COUNT TWO

24. Defendant incorporates into this answer all of the preceding answers to the complaint, as if they had been set forth in full.

25. Admitted.

26. Denied that the Pennsylvania Securities Act of 1972 is found at 70 P.S. 31, it being alleged that the Pennsylvania Securities Act of 1972 is found at 70 P.S. §1-101.

27. Denied.

28. Denied.

29. Denied.

30. Denied.

31. It is admitted that the agents and employees of Marine Bank involved in this transaction are not registered; it is denied that this is a securities transaction or that said registration is required or that the Weavers are entitled to damages as alleged.

WHEREFORE, Defendant requests that the Complaint be dismissed.

COUNT THREE

33. Defendant incorporates into this count all of the preceding answers to the complaint as if they had been set forth in full.

34. Admitted.

35. Denied.

36. Denied.

WHEREFORE, Defendant requests that the Complaint be dismissed.

AFFIRMATIVE DEFENSES

37. Defendant, Marine Bank, was not involved in or a party to the agreement attached to plaintiff's Complaint as Exhibit "A"; nor was said document ever seen by or reviewed with the agents or employees of the Marine Bank at any relevant time.

38. The Court lacks subject matter jurisdiction because the document attached to plaintiff's Complaint as Exhibit "A" is not a "security" as defined under the Exchange Act of 1934 set forth at 15 U.S.C.A. 78(c)(a)(10) for, but not limited to, the following reasons:

(a) Said document purports on its face to be contingent upon the Weavers becoming co-obligors on a note to Marine Bank (said contingency never occurred);

(b) Said document purports on its face to establish a joint venture or a partnership and is not a "security";

(c) The proceeds of the loan to Columbus Packing were used, as alleged in plaintiffs' Complaint, to pay off business debts, and as such, defendant's involvement in same, did not constitute the purchase of an investment contract.

39. This Court lacks subject matter jurisdiction because there was no "sale or exchange" of a security as set forth in the Act.

40. This Court lacks subject matter jurisdiction because the pledge of a certificate of deposit hypothecated in exchange for a loan is not encompassed within Section 78 of the Securities Exchange Act of 1934 and does not constitute a "security".

41. This Court lacks subject matter jurisdiction over Counts Two and Three of plaintiffs' Complaint because same are pendent to the claim set forth in Count One.

Respectfully submitted,

McCLURE, DART, MILLER,
KELLEHER & WHITE

By /s/
Daniel L. R. Miller, Esq. and

/s/

Christine H. McClure, Esq.
Attorneys for defendant,
Marine Bank
501 Marine Bank Building
Erie, PA 16501
(814) 453-3681

Dated: June 6, 1979

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

[Caption omitted in printing]

MOTION TO DISMISS THE COMPLAINT OR FOR SUMMARY JUDGMENT

Defendant moves to dismiss the complaint or, in the alternative, for summary judgment upon the ground that there is no genuine issue of material fact and that defendants are entitled to judgment as a matter of law in that:

1. The Court is without jurisdiction over the subject matter of the complaint and in support thereof the Court is referred to the affidavit of Robert E. Santom and John J. Daggett, the exhibits attached thereto, the depositions of Ezra Weaver and Alice Weaver, and the Brief in Support of this Motion, all attached hereto and made a part hereof.

/s/
Daniel L. R. Miller, Esq.

/s/
Christine Hall McClure, Esq.

McCLURE, DART, MILLER,
KELLEHER & WHITE
501 Marine Bank Building
Erie, Pennsylvania 16501
(814) 453-3681

Attorneys for Marine Bank

[Brief in support of motion omitted in printing]

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

[Caption omitted in printing]

STATE OF PENNSYLVANIA

SS:

COUNTY OF ERIE

Robert E. Santom, being first duly sworn, deposes and says:

I am Robert E. Santom, Vice-President and Manager, Corry area, Marine Bank, and have personal knowledge of the facts herein set forth.

This Affidavit is submitted in support of the defendant's Motion for Summary Judgment herein, for the purpose of showing that there is in this action no genuine issue as to any material fact, and that defendant is entitled to judgment as a matter of law.

1. I was the Manager of the Corry office of Marine Bank on March 17, 1978, which is the time and place of the loan transaction between Marine Bank and Raymond A. Piccirillo, Jr., Barbara J. Piccirillo, Raymond A. Piccirillo, Sr., and Mary P. Piccirillo, Ezra Weaver (a/k/a Sam Weaver) and Alice Weaver.

2. I arranged with Raymond A. Piccirillo, Jr. the details of this transaction.

3. The hypothecation agreement, guaranty agreement and assignment of account attached hereto as Exhibits "A", "B", and "C" were signed by Ezra M. Weaver and Alice F. Weaver in my presence.

4. The guaranty agreement was to guarantee to the extent of $50,000.00 the payment of a note attached hereto as Exhibit "D" and signed by Raymond A. Piccirillo, Jr. d/b/a/ Columbus Packing Company, Barbara J. Piccirillo, Raymond A. Piccirillo, Sr. and Mary P. Piccirillo.

5. I had never seen the "Agreement" attached hereto as Exhibit "E" prior to the filing of this action.

6. I had no knowledge of the contents of the "Agreement" attached as Exhibit "E" prior to the filing of this action.

7. Prior to the filing of this action, I had no knowledge of any agreement, oral or written, between Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo t/d/b/a Columbus Packing Company and plain-

tiffs in this action with respect to the profits, management or fiscal control of Columbus Packing.

8. Prior to the filing of this action, I had no knowledge of any contractual interest of plaintiffs in Columbus Packing, either oral or written, in addition to the rights and obligations set forth in exhibits "A", "B", and "C" attached hereto.

9. At all times relevant to the involvement of the plaintiffs in this transaction, the only employees of Marine Bank who had direct contact with the plaintiffs regarding the transaction were myself and John Daggett.

Further deponent sayeth not.

/s/
Robert E. Santom

[Jurat omitted in printing]

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYVLANIA

[Caption omitted in printing]

STATE OF PENNSYLVANIA

SS:

COUNTY OF ERIE

John J. Daggett, being first duly sworn, deposes and says:

I am John J. Daggett, Assistant Vice President and Assistant Manager, Corry area, Marine Bank, and have personal knowledge of the facts herein set forth.

This Affidavit is submitted in support of the defendant's Motion for Summary Judgment herein, for the purpose of showing that there is in this action no genuine issue as to any material fact, and that defendant is entitled to judgment as a matter of law.

1. I was a loan officer of the Corry Office of Marine Bank on March 17, 1978, which is the time and place of the loan transaction between Marine Bank and Raymond A. Piccirillo, Jr., Barbara J. Piccirillo, Raymond A. Piccirillo, Sr., Mary P. Piccirillo, Ezra Weaver (a/k/a Sam Weaver) and Alice Weaver.

2. My supervisor at the time was Robert E. Santom.

3. I had never seen the "Agreement" attached hereto as Exhibit "E" prior to the filing of this action.

4. I had no knowledge of the contents of the "Agreement" attached as Exhibit "E" prior to the filing of this action.

5. Prior to the filing of this action, I had no knowledge of any agreement, oral or written, between Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo t/d/b/a Columbus Packing Company and plaintiffs in this action with respect to the profits, management or fiscal control of Columbus Packing.

6. Prior to the filing of this action, I had no knowledge of any contractual interest of plaintiffs in Columbus Packing, either oral or written, in addition to the rights and obligations set forth in exhibits "A", "B", and "C" attached hereto.

7. At all times relevant to the involvement of the plaintiffs in this transaction, the only employees of Marine Bank who had direct contact with the plaintiffs regarding the transaction were myself and Robert E.

Santom.

Further deponent sayeth not.

/s/
John J. Daggett

[Jurat omitted in printing]

HYPOTHECATION AGREEMENT

The undersigned hereby authorizes Raymond A. Piccirillo Jr. d/b/a Columbus Packing (hereinafter for convenience called the "Borrower", although the Borrower's liability may be only contingent) to pledge to Marine National Bank (hereinafter called "Bank"), at any time, now or hereafter, as collateral security for the payment and performance of each and every obligation and liability, direct or contingent, of the Borrower to Bank, due or to become due, whether now existing, or hereafter arising, the following property belonging to me/us:

Marine Bank Certificate of Deposit #38240 $50,000.00 due February 1984

And the undersigned expressly ratifies, consents to and adopts any and all agreements which the Borrower has made or may hereafter make with Bank regarding the use of said collateral, and the undersigned authorizes Bank to deliver all such collateral to the Borrower or to make such disposition of it and/or proceeds thereof as the Borrower may instruct, and the undersigned agrees that any and all such agreements and instructions of the Borrower shall be applicable to such collateral exactly as if such collateral were owned by the Borrower, and the undersigned shall not be subrogated to Bank's rights in any other collateral pledged by the Borrower and/or proceeds thereof.

The undersigned hereby waives any and all notices of every kind to which the undersigned might otherwise be entitled, either of the acceptance hereof by Bank, or of the incurring of any obligation or liability by the Borrower, or the demand for payment or the payment of all or any obligations or liabilities of the Borrower to Bank whether now existing or hereafter arising, or of the presentment of any instrument for the payment of money at any time now or hereafter held by Bank in connection with any obligation or liability of the Borrower, or of protest and/or non-payment thereof, or of any exchange, sale, release or other handling or disposition of all or any such collateral, or otherwise. The undersigned agree that the duty of reasonable care as to the custody and preservation of the property deposited as collateral herein shall be limited to the duty to return the same to the undersigned upon payment of the obligations of the undersigned, and the Bank shall have no duty to

sell, convert, exercise options or warranties, or in any manner deal with said collateral for the purposes of preserving the value thereof.

In witness whereof, I/we have hereunto set my/our hand(s) and seal(s) this 17th day of March, 1978, intending to be bound hereby.

/s/ Ezra M. Weaver (L.S.)

#1138 /s/ Alice F. Weaver (L.S.)

EXHIBIT "A"

Guaranty

1. DEFINITIONS—As used herein the following terms shall have the meanings indicated:
"Undersigned" means the person, including any form of legal entity, or, if more than one, all of the persons by whom, or on whose behalf, this Guaranty is signed.
"Bank" means MARINE NATIONAL BANK.
"Principal Debtor" means Raymond A. Piccirillo Jr. d/b/a Columbus Packing Company.
"Principal Debtor's Liabilities to Bank" means all existing and future liabilities, whether absolute or contingent, of the Principal Debtor to the Bank of any nature whatsoever and out of whatever transactions arising.

2. CONTINUING GUARANTY—The Undersigned hereby unconditionally guarantees to the Bank the due performance, including, but not being limited tc, the prompt payment when due, of the Principal Debtor's Liabilities to Bank. This Guaranty is a continuing one and shall be effective and binding on the Undersigned regardless of how long before or after the date hereof any of the Principal Debtor's Liabilities to Bank were or are incurred; provided, however, that any one of the Undersigned who gives written notice to Bank to that effect shall not be liable hereunder for such of the Principal Debtor's Liabilities to Bank as are incurred after the receipt by the Bank of such written notice, unless the same are renewals, extensions or modifications of liabilities theretofore existing or unless the Bank is bound by agreement entered into before the receipt of such notice to permit the same to be incurred.

3. AMOUNT OF LIABILITY—The amount of the Undersigned's liability hereunder shall be $50,000.00 (Insert "unlimited" or limited to $_____"). If no insertion has been made in the preceding space, the amount of the Undersigned's liability hereunder shall be unlimited. If the amount of the Undersigned's liability hereunder is herein limited, the Undersigned agrees that the amount of the Principal Debtor's Liabilities to Bank may from time to time exceed the said limit of the Undersigned's liability hereunder without in any way affecting the liability of the Undersigned hereunder, and the Bank may apply any payment with respect to Principal Debtor's Liabilities to Bank to or on account of such of Principal Debtor's Liabilities to Bank and in such

orders as the Bank may elect.

4. UNCONDITIONAL LIABILITY—The liability of the Undersigned hereunder is absolute and unconditional and shall not be affected in any way by reason of (a) any failure to retain or preserve, or the lack of prior enforcement of, any rights against any person or persons (including the Principal Debtor and any of the Undersigned) or in any property, (b) the invalidity of any such rights which may be attempted to be obtained, (c) any delay in enforcing or failure to enforce any such rights even is such rights are thereby lost, or (d) any delay in making demand on the Undersigned for performance or payment of the Undersigned's obligations hereunder.

5. WAIVERS—The Undersigned hereby waives all notices of any character whatsoever with respect to this Guaranty and the Principal Debtor's Liabilities to Bank, including but not being limited to, notice: of the acceptance hereof and reliance hereon, of the present existence or future incurring of any of the Principal Debtor's Liabilities to Bank, of the amount, terms and conditions thereof, and of any defaults thereon. The Undersigned hereby consents to the taking of, or failure to take, from time to time without notice to the Undersigned, any action of any nature whatsoever with respect to the Principal Debtor's Liabilities to Bank and with respect to any rights against any person or persons (including the Principal Debtor and any of the Undersigned) or in any property, including but not being limited to, any renewals, extensions, modifications, postponements, compromises, indulgences, waivers, surrenders, exchanges and releases, and the Undersigned will remain fully liable hereon notwithstanding any of the foregoing; provided, however, that the granting of a release of the liability hereunder of less than all of the Undersigned shall be effective with respect to the liability hereunder of the one or more who are specifically so released but shall in no way affect the liability hereunder of any not so released. The death or incapacity of any of the Undersigned shall in no way affect the liability hereunder of any other of the Undersigned. The Undersigned hereby waives the benefit of all laws now or hereafter in effect in any way limiting or restricting the liability of the Undersigned hereunder, including without limitation (a) all defenses whatsoever to the Undersigned's liability hereunder except the defense of payments made on account of the Principal Debtor's Liabilities to Bank and the Undersigned's liability hereunder, and (b) all right to stay of execution and exemption of property in any action to enforce the liability of the

Undersigned hereunder.

6. PAYMENT OF COSTS—In addition to all other liability of the Undersigned hereunder and notwithstanding the limit, if any, set forth in paragraph 3 hereof, the Undersigned also agrees to pay to the Bank on demand all costs and expenses (including reasonable attorneys' fees and legal expenses) which may be incurred in the enforcement of the Principal Debtor's Liabilities to Bank or the liability of the Undersigned hereunder.

7. ACCELERATION OF LIABILITIES—If any of the Principal Debtor's Liabilities to Bank is not duly performed, including the prompt payment when due of any amount payable thereon, all the Principal Debtor's Liabilities to Bank shall at the Bank's option be deemed to be forthwith due and payable for the purposes of this Guaranty and the liability of the Undersigned hereunder.

8. CONFESSION OF JUDGMENT—The Undersigned hereby irrevocably authorizes and empowers any attorney of any court of record to appear for and confess judgment therein against the Undersigned, or any of them, for the amount for which the Undersigned may be or become liable to Bank under this Guaranty as evidenced by an affidavit signed by an officer of the Bank setting forth the amount then due, plus 15% thereof, but no less than $500, as an attorney's commission, with costs of suit, release of errors, and without right of appeal. If a copy hereof, verified by an affidavit, shall have been filed in said proceeding, it shall not be necessary to file the original as a warrant of attorney. The Undersigned waives the right to any stay of execution and the benefit of all exemption laws now or hereafter in effect. No single exercise of the foregoing warrant and power to confess judgment shall be deemed to exhaust the power, whether or not any such exercise shall be held by any court to be invalid, voidable, or void, but the power shall continue undiminished and may be exercised from time to time as often as the Bank shall elect, until all sums payable or that may become payable by the Undersigned have been paid in full.

9. NO SUBROGATION—So long as the Principal Debtor's Liabilities to Bank have not been paid in full, no payment by the Undersigned pursuant to the provisions hereof shall entitle the Undersigned, by subrogation to the rights of the Bank or otherwise, to any payment by the Principal Debtor or out of the property of the Principal Debtor.

10. OTHER GUARANTIES—A subsequent guaranty by the

Undersigned or any other guarantor of the Principal Debtor's Liabilities to Bank shall not be deemed to be in lieu of or to supersede or terminate this guaranty but shall be construed as an additional or supplementary guaranty unless otherwise expressly provided therein; and in the event the Undersigned or any other guarantor has given to the Bank a previous guaranty or guaranties, this guaranty shall be construed to be an additional or supplementary guaranty, and not to be in lieu thereof or to terminate such previous guaranty or guaranties unless expressly so provided herein.

11. MISCELLANEOUS—If the Undersigned consists of more than one person, such persons shall be jointly and severally liable hereunder. This Guaranty shall inure to the benefit of the Bank, its successors, assigns, endorsees and any person or persons, including any banking institution or institutions, to whom the Bank may grant any interest in the Principal Debtor's Liabilities to Bank or any of them, and shall be binding upon the Undersigned and the Undersigned's executors, administrators, successors, assigns, and other legal representatives. The Undersigned intends this to be a sealed instrument and to be legally bound hereby. All issues arising hereunder shall be governed by the law of Pennsylvania.

Executed this 17th day of March 1978.

(Individuals Sign Below)

/s/ Ezra M. Weaver (Seal)

/s/ Alice F. Weaver (Seal)

EXHIBIT "B"

Assignment of Account

FOR VALUE RECEIVED and intending to be legally bound, the undersigned does hereby sell, assign, transfer and set over unto MARINE NATIONAL BANK (hereinafter called "Bank") all the undersigned's right, title and interest in and to a certain deposit account in the undersigned's name in bank described as follows:

Marine Bank Certificate of Deposit #38240 $50,000.00
due February 1984

together with all monies due and to become due thereon, both principal and interest, as security for the payment of a loan in the amount of $50,000.00 made by bank to the undersigned on March 17, 1978, which loan is evidenced by a promissory note of the undersigned dated said date and in said amount. In the event of default in the payment of said note in accordance with its terms or upon the occurrence of any other event of default as specified in said note, bank is hereby authorized without notice to or demand upon undersigned to apply so much of the monies on deposit in said account as may be necessary to pay in full the amount then due and unpaid on said note or of any extension, renewal or revision thereof.

Payment in full of said note shall render this assignment void; otherwise the same shall be and remain in full force and effect. This assignment is the joint and several undertaking and obligation of the undersigned when more than one, and shall bind heirs, personal representatives, successors and assigns and shall inure to the benefit of bank, its successors and assigns.

Executed by the undersigned this the 17th day of March 1978.

/s/ Ezra M. Weaver (Seal)

/s/ Alice F. Weaver (Seal)

Assigment noted on ledger:

*By*_____

Date _____

EXHIBIT "C"

$65,000.00 March 17, 1978

For value received, Undersigned jointly and severally promise to pay to the order of MARINE BANK, a bank and trust company incorporated under the laws of the Commonwealth of Pennsylvania (hereinafter called "Bank"), at any of its banking offices, the principal sum of Sixty-five-thousand and 00/ 100 with interest at the rate of 10 percent per annum.

said interest to be payable monthly, provided, however, that in any month for which the interest charges is less than $7.50, Bank may impose a service charge which shall be the difference between the monthly interest due and $7.50. The principal hereof, together with all unpaid interest and service charges shall become due and payable (x) on demand ( ) on _____ 19___. (Unless indicated otherwise, this note is payable on demand.)

Undersigned, upon demand, agree to deposit with Bank collateral security for the payment of this and other notes and obligations of Undersigned to Bank, and Undersigned agree to deliver to Bank additional collateral, or to make payments on account, to Bank's satisfaction, so that at all times there shall be a margin of security in favor of Bank in an amount satisfactory to Bank. Undersigned hereby give to Bank a security interest in all property so given to Bank and to any property of Undersigned acquired by, or left in the possession of Bank, whether for the express purpose of being used by the Bank as collateral security, or for any other or different purpose, including safekeeping, and also upon any balance of any deposit account of Undersigned or any of them with Bank, to secure the payment of this and all other obligations of Undersigned, or any of them, to Bank, whether such obligations are due or to become due, are direct or contingent, or are now existing or herafter arise or are acquired by Bank.

On the non-payment of this note, or any installment thereunder when due, or upon the non-payment at maturity of any obligation or liability of Undersigned to Bank or any other party, or upon the failure of Undersigned forthwith, to deposit with Bank satisfactory additional property, or to make payments on account, as aforesaid, or in case of insolvency or bankruptcy of Undersigned, or any of them, or in case of insolvency or bankruptcy of any indorser or guarantor of this note, then and in any such case, this note and all other obligations and liabilities, direct or contingent, of Undersigned and each of them, to Bank, shall

forthwith, at the option of Bank, become due and payable without demand or notice, and Bank shall have the remedies of a secured party under the Uniform Commercial Code. The requirement of reasonable notice as may be imposed under the Code shall be met if notice is mailed, postage prepaid, to the Undersigned or any of them at the address shown on the records of the Bank at least five (5) days before the time of the sale of the collateral. Bank may exchange or surrender collateral from time to time, may grant extensions of time for payment hereunder or under any instrument or contract securing this note, and may proceed against all or any part of the collateral security without thereby affecting any liability of Undersigned. After deducting all costs and expenses of every kind for the collection of this note or the collection, sale, or delivery of the collateral securing the note, Bank shall apply the residue of the proceeds to the payment of Undersigned's obligations to Bank, returning the excess if any to Undersigned, who agree to be and remain liable, jointly and severally, for any deficiency. Undersigned hereby authorize and empower Bank at its option at any time to appropriate all monies now or hereafter in possession of Bank belonging to Undersigned or any of them, or credited to a deposit account of Undersigned with Bank, and apply such monies in payment of Undersigned's obligations to Bank.

All rights accorded Bank hereunder shall inure to Bank, its successors and assigns, and no delay in exercising any such rights shall operate as a waiver of such rights. Undersigned agree that Bank shall have no duty to sell, convert, exercise options or warrants, or in any manner deal with said collateral for the purposes of preserving the value thereof.

And further, Undersigned hereby authorize and empower the Prothonotary or any attorney of any court of record within the United States or elsewhere, to appear for Undersigned, and, with or without declaration filed, confess judgment against Undersigned in favor of Bank or any holder hereof, as of any term, for the unpaid balance hereof, with costs of suit and attorney's commission of fifteen percentum (15%) for collection, with release of errors, without stay of execution or right to appeal, waiving all laws exempting real or personal property from execution, and inquisition and extension upon any levy on real estate are hereby waived and condemnation agreed to, and no benefit of exemption will be claimed under and by virtue of any exemption law now in force or which may be hereafter passed. No single exercise of the

foregoing power to confess judgment shall be deemed to exhaust the power, whether or not any such exercise shall be held by any court to be valid, voidable, or void, but the power shall continue undiminished and it may be exercised from time to time as often as holder shall elect, until such time as holder shall have received payment in full of the debt, interest and costs.

The authority given in the foregoing warranty of attorney to confess judgment is: ( ) Limited (x) Unlimited

If "limited" is checked above, the following limitations shall apply (otherwise, there shall be no limitation of the authority given above):

Bank and any holder hereof expressly agree that the right to confess judgment or the exercise thereof shall not create or constitute a security interest in or a lien upon real property which is used or is expected to be used as the principal residence of Undersigned and Holder expressly release such real property from the lien of any judgment confessed pursuant to this instrument, and authorize the Prothonotary to note such release upon his records and Holder agree to make execute and deliver without cost to Undersigned any further instruments required to effectuate the above.

/s/ Raymond A. Piccirillo Jr.

/s/ Barbara J. Piccirillo

/s/ Raymond A. Piccirillo Jr.
d.b.a. Columbus Packing Co.

/s/ Raymond A. Piccirillo Sr.

/s/ Mary T. Piccirillo

DISCLOSURES REQUIRED BY FEDERAL TRUTH-IN-LENDING LAW regarding the loan evidenced by the above note are made below.

Loan Proceeds	Other Charges	Amount Financed	FINANCE CHARGE	Total of Payments
BUSINESS LOAN				

ANNUAL PERCENTAGE RATE	Payable in one payt.
_____%	☐ on demand ☐ on _____ 19___

Describe "Other Charges"_____

Check here ☐ if the following terms apply: The ANNUAL PERCENTAGE RATE of this loan may increase or decrease. It changes by the same amount or any change in the ___ _____ rate as quoted _____ but will not be more than _____% or less than _____%.

FINANCE CHARGE begins to accrue on _____ 19___ (if no date shown, on date of note) and is payable monthly. If "on demand" is checked above, FINANCE CHARGE shown is for month period; no penalty for prepayment: FINANCE CHARGE for a portion of a period is prorated. If monthly interest is less than $7.50, a service charge equal to the difference between the interest charges computed and $7.50 will be made.

COLLATERAL: The above contract creates a security interest under the Uniform Commercial Code in favor of Bank in the following property:

and in all deposit accounts of signers with Bank, and in all money and property of signers now or hereafter held by Bank, as collateral or for some other purpose. This extension of credit is further secured by

This Collateral secures this loan and all other and future debts of signers to Bank, and Signers agree to give Bank more collateral or reduce debt on demand by Bank. If "unlimited" is checked in note, the warrant to confess judgment note permits the holder of note to obtain a lien on all real and personal property owned by signers. If "limited" is checked, holder may obtain a lien on all personal property and all real property of signers excepting real property signers use or intend to use as their principal residences.

Default charges up to 15% of amount lent may be charged to cover attorney fees and court costs for collection.

MARINE BANK

By /s/ R. S. Santom

Copy of the above note and Truth in Lending disclosures received by:

/s/ Raymond A. Piccirillo Jr.

/s/ Barbara J. Piccirillo

NOTICE: See other side for important information.

EXHIBIT "D"

For value received, I/we hereby guarantee the payment of the within note at maturity, with interest and other charges, waiving protest, demand, notice of non-payment and all defenses arising out of lack of diligence in enforcing payment thereof. I/we assent to all the terms and conditions of said note, and consent that any security for said loan may be exchanged or surrendered from time to time, or the time of payment of loan be extended, without notice to or further assent from the undersigned who will remain bound upon this guaranty, notwithstanding such changes, surrender or extension. The undersigned hereby authorizes and empowers the Prothonotary or any attorney of any court of record within the United States or elsewhere, to appear for the undersigned, and, with or without declaration filed, confess judgment against the undersigned in favor of the payee or any holder hereof, as of any term, for the unpaid balance hereof, with costs of suit and attorney's commission of fifteen percentum (15%) for collection, with release of errors, without stay of execution or right to appeal, waiving all laws exempting real or personal property from execution, and inquisition and extension upon any levy on real estate are hereby waived and condemnation agreed to, and no benefit of exemption will be claimed under and by virtue of any exemption law now in force or which may be hereinafter passed. No single exercise of the foregoing power to confess judgment shall be deemed to exhaust the power, whether or not any such exercise shall be held by any court to be valid, voidable, or void, but the power shall continue undiminished and it may be exercised from time to time as often as holder shall elect, until such time as holder shall have received payment in full of the debt, interest and costs.

_____ (Seal)

_____ (Seal)

_____ (Seal)

Property of signers deposited with Bank as collateral (Continued from other side):

NOTICE: See other side for important information.

[Exhibit "E" of the affidavits, the agreement between Raymond A. Piccirillo, Jr., Barbara J. Piccirillo, his wife, t/d/b/a/ Columbus Packing Company and Samuel Weaver and Alice F. Weaver, his wife, is reproduced at page JA-11 of this appendix.]

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYVLANIA

[Caption omitted in printing]

PLAINTIFF'S ANSWER TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

AND NOW, comes the plaintiffs, Ezra Weaver and Alice Weaver, by their counsel, Dunn & Conner, by Andrew J. Conner, and answers defendant's Motion for Summary Judgment alleging as follows:

1. That there was the purchase and sale of a security by Weaver to Marine Bank and specifically, a sale of a $50,000 certificate of deposit to Marine Bank on March 17, 1978.

2. That they purchased a second security on March 17, 1978 "in connection with" the transaction made reference to in the above paragraph of this answer.

3. There are genuine issues of material facts as to whether the defendant, Marine Bank violated Section 10(b)5 of the 1934 Securities and Exchange Act and Section 17(a) of the 1933 Securities and Exchange Act in connection with the purchase and sale of the aforementioned securities, causing the Weavers at least $50,000 in damage, all of which would preclude the courts from granting defendant's Motion for Summary Judgment.

4. Attached to this Answer, is the affidavit of Ezra and Alice Weaver, plus Exhibits.

Respectfully submitted,
DUNN & CONNER

By: /s/
Andrew J. Conner
Attorneys for Plaintiffs,
Samuel and Alice Weaver
1111 Baldwin Building
Erie, Pennsylvania 16501
(814) 453-6011

Dated: December 18, 1979

[The unlettered exhibit to the answer, the agreement between Raymond A. Piccirillo, Jr., Barbara J. Piccirillo, his wife, t/d/b/a Columbus Packing Company and Samuel Weaver and Alice F. Weaver, his wife, is reproduced at page JA-11 of this appendix.]

AFFIDAVIT

STATE OF PENNSYLVANIA

SS:

COUNTY OF ERIE

BEFORE ME, a Notary Public, personally appeared EZRA WEAVER and ALICE WEAVER, who, being duly sworn according to law, depose and say that the facts set forth herein, are true and correct to the best of their knowledge, information and belief.

1. Our names are Ezra (Sam) and Alice Weaver. We are the plaintiffs in this action. We reside at R.D. #4, Union City, Pennsylvania. We are presently 79 years of age and 71 years of age, respectively.

2. Our formal education is limited to that of the 8th grade. We have had no other formal education or accounting experience in our working life. For the greater part of our working life, we have been dairy farmers and livestock traders and since October of 1977, we have operated a small livestock auction in the Union City, Pennsylvania area.

3. On February 28, 1978, we were the co-owners of a $50,000 certificate of deposit which we purchased at the Corry office of the Marine Bank. This certificate of deposit was Serial No. 38240 and had a due date in February of 1984. We purchased that certificate of deposit on that date for purposes of having money available for the operation of our livestock auction made reference to above.

4. Prior to March 17, 1978, we did not owe the Marine Bank any money. Further, we were not a creditor and/or debtor Raymond Piccirillo, Jr., d/b/a/ Columbus Packing. We had no investment interests whatsoever in the business known as the Columbus Packing.

5. On and prior to March 17, 1978, we were both solicited and induced by Thomas Daggett and Robert Santom, officers and employees of the Marine Bank to pledge, the $50,000 certificate of deposit, made reference to above, to the Marine Bank in exchange for the Marine Bank using all, or substantially all of the $50,000 and/or its proceeds, for working capital for Raymond Piccirillo, Jr., d/b/a Columbus Packing.

6. On March 17, 1978, we pledged the certificate of deposit, made reference to above, to the Marine Bank, based upon the representations and solicitations of the employees of Marine Bank made reference to above.

7. It was specifically represented by Thomas Daggett and Robert

Santom of the Marine Bank, with respect to our pledging of this certificate of deposit to Marine Bank as follows:

(a) all or substantially all of the $50,000 represented by the certificate of deposit would be made available to Raymond Piccirillo, Jr., d/b/a Columbus Packing for working capital;

(b) that there would be little or no risk to the Weavers' making this pledge of this certificate of deposit because the Marine Bank had a perfected lien on Columbus Packing's equipment and that the value of this equipment was substantially in excess of the $50,000 and whatever indebtedness Columbus Packing owed; and

(c) that Marine Bank would provide the Weavers' with a monthly profit and loss statement.

8. On and prior to March 17, 1978, the Marine Bank did not make the Weavers' aware, and the Weavers' were not otherwise aware of, the following:

(a) that Marine Bank was owed any money by Raymond Piccirillo, Jr., d/b/a Columbus Packing was delinquent on any loans to the Marine Bank ;

(b) that Columbus Packing was overdrawn, and had been overdrawn, in substantial amounts of money in the checking account which Columbus Packing maintained at the Marine Bank ;

(c) that the Small Business Administration in September of 1977 had refused to make a loan to Columbus Packing;

(d) that Raymond Piccirillo, Jr., d/b/a Columbus Packing was insolvent and was in a negative capital position in 1977 and 1978;

(e) that Raymond Piccirillo, Jr., d/b/a Columbus Packing owed the United States Internal Revenue Service withholding taxes for 1977 and 1978;

(f) that Raymond Piccirillo, Jr., d/b/a Columbus Packing was in a bad financial condition;

(g) that at least $42,000 of whatever proceeds were going to be generated by the Weaver's pledge of the $50,000 certificate of deposit would be paid back to Marine Bank to reimburse it for the overdrawn checking account and reimburse it for the notes and loans which Marine Bank had made to Columbus Packing in 1977 and 1978, and;

(h) that Columbus Packing was not going to realize anymore than $3500 - $4000 in working capital as a consequence of the Weavers' pledging the $50,000 certificate of deposit made reference to above.

9. On March 17, 1978, we pledged the certificate of deposit to the

Marine Bank and in connection therewith, in consideration for receiving an agreement from Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo, d/b/a Columbus Packing Company to share in the profits in the operation of Columbus Packing Company with a true and correct copy of the agreement being attached to this affidavit, designated Affidavit Exhibit A.

/s/
Ezra Weaver

/s/
Alice Weaver

[Jurat omitted in printing]

EXCERPTS FROM THE DEPOSITION OF ROBERT SANTOM, MARINE BANK TAKEN JULY 3, 1979 AND FILED IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

* * *

[TR. 91] Q. Are you familiar with the F.D.I.C. procedure of classifying loans?

A. Yes sir.

Q. Can you tell us what your knowledge of that is?

A. Well, when the examining force comes in from the F.D.I.C., the Federal Deposit Insurance Corporation, they classify loans which they consider to be potential losses to the bank, and at that time, if they consider it to be a potential loss, they instruct the bank to charge that thing off against profits that the bank has. They will classify loans as doubtful; they will classify loans as being classified for purposes of inadequate financial statements, evidence of inability to repay because of inadequate cash flows. There are many different types of classification. I think primarily there are three.

Q. What are the three?

[TR. 92] . Well, here again, I think it's doubtful—or number one would be the classification of inadequate information; number two would be doubtful, and number three would be what they consider to be a loss in those particular areas.

Q. Do you know whether or not the Columbus Packing loan was ever classified?

A. To the best of my knowledge, that loan did not appear on any classified report by the F.D.I.C., at least none that I saw.

Q. With regard to the state banking people, do they have a similar type procedure that classifies loans?

A. Yes sir.

Q. Why don't you tell us your knowledge of that?

A. Well, it's basically the same system as the F.D.I.C.; they work in conjunction one with the other; they audit at the same times, as a matter of fact. Their classifications are almost identical.

Q. Do you know whether it was ever classified under the state banking procedure, and I'm talking about the Columbus Packing loan?

A. To the best of my knowledge, it was not, at least on any reports that I saw.

[TR. 95] Q. Okay, there's one other document here that we had marked and I want to make sure we have that, and that's the accounting statement that we asked Mr. Daggett some questions about. Showing you Daggett Exhibit 2, can you tell us whether or not you're familiar with that document?

A. This is apparently a financing statement that has been presented by Columbus Packing Company under the date of October 31st of 1977.

Q. Do you understand that that was presented to Marine Bank?

A. If it were found in our folders, I would assume it was presented to Marine Bank.

Q. Did you ever review that accounting statement?

[TR. 96] A. I may have glanced at that particular accounting statement, but I was dealing on a more current basis with Piccirillo in my conversations with him.

Q. Did you ever have any more current accounting information from Mr. Piccirillo other than the information contained in Daggett Exhibit 2?

A. Only from a standpoint of a listing that he prepared by handwriting of receivables and payables that he had, and based on certain sales that he had had over the past six or seven months.

Q. I think you indicated that Columbus Packing's financial condition remained relatively stable between December of '77 and March of '78?

A. Yes. I didn't see anything that would change his condition from the time that I began negotiations with him at the early part of January, '78 through March, '78.

* * *

[TR. 99] Q. With regard to the accounts receivable and inventory, just confining myself to those items, would it indicate to you on your records as compared to October 31st, 1977, that there had been a worsening of his condition between October of '77 and December of '77 when you started work on this particular account?

A. That would be the indication to me, yes.

Q. Now, with regard to the document titled Daggett Exhibit 2, and from your experience as an accountant, can you tell whether or not Columbus Packing as of October 31, 1977 was solvent?

A. Columbus Packing Company, to the best of my knowledge, has never been solvent, has never had an adequate capital base; that was the primary problem they were dealing with right from the very beginning.

* * *

[TR. 106] Q. I think you indicated that the debt position of Columbus Packing was a topic that was discussed?

A. Yes sir.

Q. What was discussed with respect to the debt position of Columbus Packing Company?

A. At that point it was pointed out the amount of money that would be needed to properly restructure the debt and inject adequate operating capital into the business, what existing debts would be paid off with those funds in order to bring the payment position into a place where it could be handled by Columbus Packing adequately. I had at that point a list of obligations which would be paid off, the payoff balances on those particular obligations, and I think at that point in time, it may have been approximate figures; they were not exact payoff figures, because we didn't have a closing date on the loan on the date that I had met with Piccirillo and Weaver, but I had approximately the amount that coresponded to the need for a new debt position with Columbus Packing Company of sixty-five thousand dollars.

Q. From your standpoint, how much working capital **[TR. 107]** would Columbus Packing need to make it a viable operating concern?

A. Well, with the consolidation of the debt position that he had, consolidating those monthly payments into a one-payment situation over an extended period of time, and the elimination of the current overdraft position in the account, we felt that the injection minimum of ten thousand dollars would be required into the operating account to keep it going at that point.

Q. When had you made that analysis?

A. Probably sometime in our early conversations with Piccirillo in January, February, when we were first doing the analysis on the account, determining what the problems were with regard to Columbus

Packing Company, and I had given Mr. Piccirillo on more than one occasion the minimum requirements that the bank would consider for the purpose of restructuring the debt.

Q. What were the minimum requirements?

A. A consolidation of those existing debt positions, plus a minimum capital injection of ten thousand dollars operating cash.

Q. Would the consolidation and injection of **[TR. 108]** ten thousand dollars, as you have defined as the minimum requirements, make Columbus Packing solvent?

A. That in conjunction with the tightening down of certain of his expenses; for example, reducing his two-business operation into a one-business operation, which we discussed with him at length.

Q. Why don't you be specific with regard to that, because that's something new today.

A. Well, he has a wholesale slaughterhouse which contained a retail outlet when he originally started his business, when he originally acquired the business. Subsequent to that, he branched out and opened up a retail meat market in Corry, Pennsylvania. He hired a manager to run that thing, he hired meat cutters to work in the place, and our recommendation was that he close that operation down, move that retail operation back into the wholesale plant where he had the facilities, and eliminate some of his overhead costs.

Q. How much overhead cost did you anticipate eliminating because of that step?

A. I can't recall the figures offhand. I would say probably a minimum of salaries of twelve thousand dollars a year, **[TR. 109]** a rental figure of one hundred and a quarter a month, plus his expenses for light, heat, things of that nature. I don't recall the total position at this point.

Q. If he hadn't done that, and assuming that these other things being equal that we have just discussed, would Columbus Packing have been solvent with a ten-thousand-dollar capital investment?

A. I can only answer your question to say that he would have been more solvent than what he was prior to that time and he would have at least had the opportunity to salvage the business. He was going to have to make some sacrifices at that point himself in taking salary out of the business.

[Off-the-record discussion.]

[Answer read.]

Q. In that context, you mentioned salvaging the business. Can you tell us specifically what you mean by the word "salvage" the business in that context?

A. Well, I think we can all be aware of the fact that Columbus Packing Company was having financial difficulties primarily in the areas of cash flow. By the consolidation of the debt position that he had, and reducing **[TR. 110]** the monthly outlay of cash for payments, he would have been in a much healthier position at that point.

Q. And is that what you mean by salvaging the business?

A. Yes sir.

***

[TR. 122] A. In my opinion, the collateral was very close to liquidating the overdraft situation, including the overdraft.

Q. During the meeting of March 15, 1978, do you recall mentioning to Mr. Weaver the dollar figure, in your opinion, that would be left for working capital after all these expenses were paid out of the sixty-five-thousand-dollar loan, and if so, what was the dollar figure?

A. To the best of my recollection, we talked in the neighborhood of about ten thousand dollars.

Q. And was identified as being available for working capital?

A. That's correct.

Q. And from your analysis, if Columbus Packing had ten thousand dollars in working capital at that time, would they have been a viable operating company?

A. Again, in my opinion, under the conditions of the debt restructuring, under the conditions of the other things that we had talked about in the way of controlling expenses, this company had an opportunity to make it. It was going to be a struggle for them, but they had an opportunity to make it, in my opinion.

***

[Tr. 124] Q. What consideration or value, if any, did Marine Bank intend to give Mr. Weaver in exchange for his pledging fifty thousand dollars?

A. Well, interest on his certificate of deposit would be the only consideration that I was aware of.

Q. Let's talk about that, the interest on the CD. So what you're talking about is the interest rate that would be payable under that

particular certificate of deposit, is that correct?

A. That's correct.

Q. And that's something that he had before he made this pledge, is that correct?

A. Well, I don't know that. I don't know where these things were prior to his coming in and depositing them in our bank. I don't know whether he had them in a checking account or a savings account.

Q. What, if anything, did Mr. Piccirillo, in your presence, indicate he was willing to give Mr. Weaver in exchange for Mr. Weaver doing this?

A. I don't recall having heard Tony say anything at all to Sam Weaver about what he was going to do or—I don't recall **[TR.125]** anything on that line.

Q. What was your understanding, if any, as to what Mr. Weaver was going to receive from Mr. Piccirillo or Columbus Packing?

A. I can recall one particular conversation that I had with Tony about this and he implied that his connections with the farmers around the area and so forth was going to assist in increasing the sale of cattle through Sam's auction barn, but that was the extent of any conversation. Beyond that point, there was no conversations about it.

Q. What, if anything, did Mr. Piccirillo—and I'm talking about specifically Mr. Piccirillo in his relationship to Columbus Packing—what, if anything, of value did he have at that time, either by way of assets or investments, to give Mr. Weaver in exchange for Mr. Weaver pledging the fifty-thousand-dollar certificate of deposit?

A. To the best of my knowledge, outside of the assets that were already pledged to the bank, I don't believe Mr. Piccirillo had any assets or anything of value that he could pledge with Mr. Weaver.

Q. Was it your understanding that whatever Mr. Weaver was to receive as a consequence of this was to come from Mr. **[TR. 126]** Piccirillo or Columbus Packing as opposed to Marine Bank?

A. I didn't have any understanding about return to Mr. Weaver. My understanding of the matter was that Mr. Piccirillo had known Weaver for a number of years, and it's my understanding that Mr. Weaver was doing this to help Mr. Piccirillo out of a problem he was having. There was no conversations about anything in the way of payment for that service, or anything of that nature.

Q. Was it your understanding that he was to receive nothing of value from Mr. Piccirillo or Columbus Packing as a consequence of this

other than what you've just described?

A. I have no knowledge of anything outside of that.

***

[Tr. 150] Q. Now, with regard to the equipment, and I'm talking about the equipment you may have had a security interest in, can you tell us what steps, if any, you took with respect to the equipment after you became the debtor in possession?

A. We took over as debtor in possession, we padlocked the doors, we put our own insurance on the equipment to protect the bank. Shortly after that we were notified that the bankruptcy proceedings were under way. We turned all of the assets over to the trustees in bankruptcy, and it was at that time that we learned that our filing of our security agreement financing statements were not within the time limits of the bankruptcy, and therefore, we lost our perfected position.

Q. On the equipment?

A. On the equipment, accounts receivable and **[TR. 151]** inventories; everything was on that financing statement.

Q. Was that the first time that you had realized that there was a problem with the filing of the security agreement?

A. Yes, it was.

Q. And the date of that is June 21st, June 22nd of 1978?

A. I'm not sure when the filing of the bankruptcy took place, but it was in this time frame that we learned this.

Q. Now, you've mentioned the term "restructuring" the loan, I think that's the term that you used, with reference to this particular transaction, is that correct?

A. Yes, it is.

Q. Can you tell us when it was that you had made a decision as to restructuring this particular loan?

A. Well, the conversations started back in December and January with Mr. Piccirillo as the owner-manager of Columbus Packing Company, and it was during those negotiations that we pointed out to Mr. Piccirillo that he could not continue in business under the present status that he had, because he didn't have a sufficient amount of cash **[TR. 152]** flow going, that it was absolutely necessary that he inject additional capital into his business or to restructure the debt in such a way that it would improve his cash flow on a monthly basis. We told Mr. Piccirillo that he had to come up with some money somewhere along the

line to put into the business to eliminate the debt position that he had so he wouldn't have such big payments, or to restructure the loans. Mr. Piccirillo went out and attempted in several different areas to raise capital. He talked to at least one other financial institution that I know of to restructure his debt position and inject additional capital into his business, and then the net results of those were the Weaver transaction in which we were satisfied with the collateral position to go ahead and risk restructuring the debt position.

Q. Okay, did you encourage Mr. Piccirillo to go out and secure investors for his business?

A. Not at all. We told him what was absolutely necessary, gave him the choice of doing either that, finding a buyer for his business, or selling the business and going out of business.

***

[TR. 167] Q. This is a banking document?

A. That's what we call a spread sheet. That's what lending officers will use to spread and analyze an account. There is another portion to it which is the reverse side to it that gives you some R&A percentage factors, and so forth.

Q. From your understanding of the document, there was an indication, I believe, in the column or row identified as row 11 identifying a number for fixed assets, and it indicates one hundred and thirty-seven thousand four hundred and sixty-seven dollars of fixed assets?

A. Okay.

Q. And then down at the lower column, identified as row 18, for total assets there is an identification of one hundred and sixty-six thousand four hundred and forty-nine dollars.

A. Okay. That's a combination of these two figures.

Q. Yes, a combination of current total assets and fixed assets. There is no indication as far as what the liabilities are on this document, is that correct?

A. No.

Q. Okay, now as of March 17, 1978—or March 15, 1978, if you will, had Weaver not been willing to pledge th[illegible] **[TR. 168]** fifty-thousand-dollar certificate of deposit, what course of [illegible]ction, if any, was the bank going to take.

A. Well, I think I gave you those courses of action that we had

laid before Piccirillo: number one, to inject the capital into the business; number two, if that could not be accomplished, then the next thing for him to do was to find a buyer for the business and sell it, and if he couldn't accomplish that, then the next thing for him to do was to sell off the assets, reduce the debt position at that point in time and get out of the business. The next alternative to that would have been that the bank would have taken the position of foreclosing the business and recapturing our assets and liquidating the debt position.

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EXCERPTS FROM THE DEPOSITION OF JOHN DAGGETT, MARINE BANK, TAKEN JULY 3, 1979 AND FILED IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

***

[TR. 19] Q. You mentioned a file. Did you in the ordinary course of your duties at Marine Bank keep a file or have possession, custody or control over a file relating to Columbus Packing?

A. No.

Q. You kept no file yourself?

A. No.

Q. Did you have access to a file?

A. Yes.

Q. Okay, and who would have had the file itself? Who would have physically controlled the file that you had access to?

A. Well, normally, there is no one that physically controls the file. We keep all our files in the central **[TR. 20]** filing area in the bank.

Q. And they would be kept under the name of the account?

A. Yes.

Q. And in the course of your duties, if you wanted to go and look at a file, you could go and look at a file if you so desired?

A. Correct.

Q. Starting in January of '78 and running, say, through February of '78, could you just tell us in chronological order what steps, if any, you took with regard to handling this particular account, and I'm talking about the Columbus Packing account?

A. Yes. I became—I considered myself involved in this when Tony approached me that there was some conversation with Bob and Tony that Tony needed to have capital in the business, capital had to be injected in the business, something had to be done to bring this thing around. Tony came to me with an investor, that investor being Sam Weaver. He came to my desk one day and discussed this with me, and that was the first time I became involved, other than routine assignments as a lending officer to work with it under the **[TR. 21]** direction of Will and Bob, but that was really my first involvement with it. From that point, I gave Tony applications; he took them and brought them back filled out with Sam Weaver to show a little bit of what Sam was worth

and how he could be involved, and such, and that's how it started. Then—and I'm not sure of the dates on this actually when these things happened, but Tony had set up a meeting with myself and Sam. Sam preferred to meet at his house. He didn't want to come to the bank because he didn't feel right in the bank with the clothes he wore, and working around the farm and stuff, so I agreed to do this, and we met at his trailer, and I was there for maybe a couple of hours and discussed all the various ways that possibly Sam could get involved. He asked, you know, what he would need as collateral and how he would become involved, and I tried to explain to him to the best of my ability the various ways that he could become involved in the loan if he wanted to, through land, through money, and he decided he didn't want to involve any of his property, and this is how we came down to the dollar amount, the cash amount, by bringing in the certificate. That was the first time, but then Sam would call me. I would stop, because I have to go by his home, on the **[TR. 22]** way to work, and one day he would be in favor of becoming involved with Tony and then he wouldn't, he would change his mind and not be. I don't know how many times Sam called me, and maybe a couple times I would stop and he would ask me some particular question on maybe what Tony was doing, and I would answer this and leave, and so this went on, and I'm not sure of the dates, until finally he did agree on a specific amount and that was settled with Tony and Bob, and at this time, I was at the Mellon School, so I was out of the bank for a week when the events actually happened. So that was my contact with the loan and with Sam and Tony.

Q. Okay, so let's go back so we can try to get these things defined more specifically. You mentioned that there was a time, I think, when Tony came to you indicating that he had talked to Bob, indicating Mr. Santom?

A. Yes.

Q. And he had indicated that, according to Bob, that he, Tony, needed investors in Columbus Packing?

A. He needed money into the—somehow he had to get some money into the business, that there just wasn't enough money to support the debts and give him a cash flow.

***

[TR. 24] Q. Did he indicate any dollar amount that Mr. Weaver was interested in investing in the business?

A. Not at that time, I don't think.

Q. And then thereafter, did you then meet with Mr. Weaver?

A. Yes.

Q. And who set that meeting up?

A. Tony did.

Q. And where was the meeting?

A. At Sam's house, Mr. Weaver's house.

Q. And would I be correct that this was either in January or February of 1978?

A. Yes.

Q. And who was present at that meeting?

A. Mr. and Mrs. Weaver, Tony and myself.

Q. And the purpose of the meeting was what, as you understood it?

A. A general discussion on the condition of Tony's business, what Tony needed, and how Sam could become involved and help him.

Q. What discussion was there as to the condition of **[TR. 25]** Tony's business.?

A. Well, that it needed money and that without capital, without money put into this business, it really would not be able to exist very much longer.

Q. Okay, was that stated?

A. Yes.

Q. And was there any discussion as to how much money Piccirillo or Columbus Packing owed Marine Bank at that time?

A. I think so, but I'm not sure.

Q. Who stated anything with regard to what Columbus Packing owed Marine Bank at that meeting, if you can recall?

A. How much they owed Marine Bank?

Q. Or whoever stated anything—

A. Well, it would have to be me, because I had the figures with me as far as dollars. What would be needed and what their debt was, I'm sure I would have to say it would come around to a dollar amount.

Q. You would have been the one that would have been privy to that information specifically?

A. At that meeting, yes.

* * *

[TR. 30] Q. Was there any indication as to what Marine Bank

intended to do if Mr. Weaver either invested or loaned any money to Columbus Packing?

A. What they intended to do?

Q. Right. Did you ever tell Mr. Weaver as to what Marine Bank intended to do if Mr. Weaver made an investment of any sum of money into Columbus Packing?

A. Well, at that meeting, I would say no, because that meeting was very general in how much money—between Tony and Sam, they kicked around different amounts, some things that Tony would like to do. They kicked around various dollar amounts. My conversation with him was very general in his investment and what collateral he could use. That's what was really the purpose of the meeting.

Q. You're talking about Mr. Weaver's investment?

A. Right.

Q. And you mentioned dollar figures. Can you just recall here today what dollar figures were mentioned in that **[TR. 31]** conversation?

A. Well, it seemed to me at first that Sam and Tony were talking one hundred thousand dollars initially. That was the first dollar amount that was being kicked around.

Q. Okay, were there any other dollar amounts other than one hundred thousand?

A. That was the highest. I don't know what it went down to from there.

Q. You can't recall the lowest?

A. Well, I think the lowest was fifty thousand. I think that's what the lowest—that's what Sam agreed to invest in the business.

Q. What did you understand from that conversation as to what type of return Weaver was going to receive for his fifty thousand or one-hundred-thousand-dollar investment?

A. None.

Q. You had no understanding one way or the other?

A. No.

* * *

[TR. 37] Q. Was he current on his payments at the time that you first sat down and talked to Mr. Piccirillo and Mr. Weaver?

A. I don't know if it was that day.

Q. Okay, were there any other conversations in the first meeting that you can recall that Mr. Weaver made or Mr. Piccirillo made as

you're sitting here today?

A. Other comments?

Q. Any other conversation that took place that you can recall here today, other than the conversation or comments that you have summarized here in your testimony.

A. Well, there was a lot of conversation, but it was all pertaining, you know, to this loan.

Q. Okay, now, you say "this loan". Was there any discussion at that time that Marine Bank would be willing to loan Mr. Piccirillo some money if Mr. Weaver made an investment in Columbus Packing?

A. If the loan could be restructured under the proper money being invested, that Marine Bank would be willing to do this, yes.

Q. Did you express that to Mr. Piccirillo and Mr. Weaver?

[TR. 38] A. Yes.

Q. Now, you mentioned, I think, the proper amount—am I using the right term?

A. Proper amount?

Q. Yes, is that the term that you used?

A. For restructuring the debt?

Q. Right.

A. Yes, I think so.

Q. Did you express the proper amount?

A. No.

Q. That wasn't discussed?

A. The proper amount was discussed in general terms, but as I said, I went out there with Tony and Sam talking one hundred thousand dollars. That was the amount that they were talking first that Sam was going to invest, so that dollar amount was discussed. But the proper amount, what the proper amount was, I'm not saying that would have to be the proper amount, but that dollar amount was discussed.

Q. Was there a second meeting between you, Mr. Piccirillo and Mr. Weaver?

A. Not together, no. I met with Sam, but not with Tony there.

[TR. 39] Q. Okay, was there a second meeting between you and Mr. Weaver then?

A. Yes.

Q. And this took place at Mr. Weaver's home?

A. Yes.

Q. And I think you had indicated in your prior testimony that

Mr. Weaver had requested that the meeting take place at his home?

A. That's correct.

Q. Can you tell us, if you recall, who was present at that second meeting?

A. Only Sam and myself. I think the second meeting—in fact, Sam was on a bulldozer or a plow. He called me, I think it was before seven o'clock in the morning, actually got me out of bed, and asked me if I would stop out and he had some questions for me, and I said yes, I would, and I did do this, and it was probably like eight o'clock, and like I said, he was concerned, you know, whether to be involved or not, and I'm not sure what the questions were he would ask me. He would ask me—I'm not sure what his questions were, and I would talk to him and he would call me on the phone and I would talk to him on the phone.

* * *

[TR. 59] Q. Did Marine Bank ever give him anything of value in exchange for pledging the fifty-thousand-dollar, or tendering to you the fifty thousand dollars on 2/28/78?

A. Of value, no.

Q. What, if anything, did Mr. Piccirillo have to give Mr. Weaver that you were aware of?

A. Nothing.

Q. Can you tell me, Mr. Dagget, whether or not Marine Bank ever gave Mr. Weaver anything of value in exchange for the fifty-thousand-dollar certificate of deposit that you can tell us about today?

A. The only thing he would get for the fifty thousand dollars, he would receive interest on his certificate, that's all.

Q. That's the interest payments that would normally **[TR. 60]** and customarily be due?

A. On a certificate at that time, yes.

Q. But other than that, that's the only thing that you could state that Mr. Weaver would be receiving?

A. Yes.

Q. What was your understanding as to what, if anything, Mr. Weaver was to receive from either Mr. Piccirillo or Columbus Packing in exchange for giving or pledging the fifty-thousand-dollar certificate of deposit to the Marine Bank?

A. Nothing.

Q. And when you say nothing, you had no understanding or

there was nothing that was going to be given by Mr. Piccirillo or Columbus Packing to Mr. Weaver?

A. That's correct. That confused me, because I could never understand why Mr. Weaver would want to be involved, but there was nothing that I was aware of.

Q. Did you ever ask Mr. Weaver why he was willing to do this?

A. No, I don't think so, no.

Q. Did you ever ask Mr. Piccirillo as to why Mr. Weaver was doing it?

[TR. 61] A. Yes.

Q. What was your response from Mr. Piccirillo?

A. The only thing that Tony ever said, that he would possibly be able to help Sam in his business, that Tony knew a lot of farmers that may be able to help Sam's business, because Tony knows a lot of people who Sam didn't. And Sam's age, Tony would be a much younger man and stuff, that he might be able to help him that way.

Q. Was this related to you before or after the time that Mr. Weaver gave Marine Bank the certificate of deposit on 2/28/78?

A. That would have to be before.

* * *

EXCERPTS FROM THE DEPOSITION OF EZRA M. (SAMUEL) WEAVER, PLAINTIFF, TAKEN AUGUST 10, 1979 AND FILED IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

* * *

[TR. 13] Q. Did Mr. Daggett come at your request?

A. I never asked him to.

Q. You never called him?

A. Never called him.

Q. Did he call you?

A. I would think so, when he called me when he would be up to my place, that was all.

Q. Did he call you on the telephone before he came to see you?

A. Sometimes, yes, to see if I would be home.

Q. Did he make any statements to you that Mr. Piccirillo, Jr. had sent him or had requested that he come?

A. No. No, he never told me anybody outside of that he would like me to furnish some working capital for Mr. Piccirillo through the bank.

Q. What was your first contact with Marine Bank?

A. Mr. Daggett. Well, the first contact, you mean when I put the money in the bank?

Q. The first contact on this whole transaction, what was your first contact with the bank?

[TR. 14] A. To loan the money for Piccirillo?

Q. Uh-huh.

A. When Mr. Daggett come to my place.

Q. Was anyone with him?

A. No, he came alone one morning, cold morning when I was plowing snow. And I told him at that time no deal, I didn't want no part of it. I practically chased him home.

Q. Was anyone with him?

A. No. He had a big suitcase, I suppose full of money, and I—it was a cold morning and I was plowing snow.

Q. Was your conversation outside?

A. Outdoors, where I told him when the tractor was running, I

told him I didn't want no part of this deal. And I kept telling him that; he kept coming back.

Q. Well, let's deal with that first time. After he left did Mr. Piccirillo come back to see you?

A. No, I never—he didn't come to me, for no reason. He's never contacted me.

Q. Have you ever talked to Mr. Piccirillo on the telephone about this working capital need of yours?

[TR. 15] A. I never did.

Q. Did Mr. Piccirillo ever come to the auction barn and talk to you about it?

A. No.

Q. Did you ask Mr. Daggett to drop by?

A. I never did. In fact, I wanted him to stay the hell away. He kept bothering me.

Q. Did you and Mr. Daggett have any discussion following this interview on the tractor when you were outside?

A. He came to my place one day with his rubber boots to go back in the field to look me up, but he didn't make it. The mud was too deep.

Q. Well, when you talked to Mr. Daggett, how many times did you talk to him at your place of business?

A. Well, he came one time after a sale, after we had had a sale. I can't tell you how many times, but he kept acoming for a loan.

Q. Well, how many times?

A. I wouldn't say. I couldn't keep track of how many times. Every time I'd look up he'd be coming.

* * *

[TR. 18] Q. When you talked to Mr. Santom in the bank who was present?

A. Nobody but my wife and I. That's the only time I was to the bank before this transaction, when we signed this paper.

Q. When Mr. Santom was with you and Mrs. Weaver at the bank did he explain the transaction to you?

A. He certainly did. He said it was working capital for Piccirillo, the same as he told me when he came to the trailer.

* * *

[TR. 19] Q. After Mr. Santom was at your trailer did you buy a

certificate of deposit at the Marine Bank?

A. No. this was a long time before that.

Q. How long before?

A. Well, I can't tell you, but I—it was a long time before I knew Mr. Daggett or Mr. Santom or anybody. Didn't have no idea I was going to use this money when I put the money in the Marine Bank, for anything but my business, is why I transferred the money from North East bank over here.

Q. But you did buy, probably in February of 1978 a fifty-thousand-dollar certificate?

[TR. 20] A. At the Marine Bank, the small bank.

Q. Right, and that was done at the North Corry branch?

A. The North Corry bank.

* * *

[TR. 28] Q. Would you say that what you were to reeive was two things, the hundred dollars a month plus fifty percent of the adjusted profit?

MR. CONNER: I'll object to the form of the question because the agreement speaks for itself, and I object to the form, but go ahead and answer the question.

DEPONENT: Tell me that question again.

Q. Were you to receive for your signature two things, a hundred dollars a month until your signature was removed, and fifty percent of what is called the adjusted net profit?

MR. CONNER: Same objection, but go ahead and answer the question.

A. I imagine that was what was in the agreement.

Q. Did Mr. Piccirillo leave a copy of that with you?

A. He did.

Q. When was this agreement executed?

A. There's no date on it. I wouldn't know, I**[TR. 29]** don't know when it was executed. He came in and throwed this paper down and he said he'd give me a little percentage of the business if I'd loan him some money through the bank, and I signed it.

Q. That was before March 17th, though, wasn't it?

A. That was before the time of this transaction.

Q. Did you ever tell the Marine Bank about that agreement?

A. No, they never knew about that agreement, that I know of. I

never told them. In fact, I never was to the bank from the time I loaned the money, put the money in the CD. I never was to that bank, I never was to the big bank until the time I signed this thing with this guy.

Q. Mr. Santom you're pointing to?

A. Yes sir.

* * *

[TR. 44] Q. After the loan closing did you stay in touch with Mr. Piccirillo?

A. No.

Q. Did you ever see him again?

A. Well, he—after the closing I think he brought us over some hamburg after that. He hadn't closed his place up yet.

Q. He stayed in business for some time after the closing, didn't he?

A. He stayed in business a week or two, you know.

[TR. 45] First thing I know that any of this money had been distributed anywheres else his checks started bouncing with me. I still got one for fourteen hundred dollars, and he gave me another for seventeen hundred. I got that money out of him, cash. That's the first time I—and then he explained to me that the bank had took all this money except ten thousand dollars and the IRS got six of it.

Q. Well, when he started bouncing checks, what were those checks for?

A. Livestock. I thought his check would be good after he had a loan through the bank of my money. I thought it would be good, so I allowed him to buy. He came himself and bought it each time.

Q. About how many times did he come and buy after the closing?

A. About a couple times is all.

Q. Two or three?

A. Yes, two or three that's all. He always had a buyer.

* * *

EXCERPTS FROM THE DEPOSITION OF ALICE F. WEAVER TAKEN AUGUST 10, 1979 AND FILED IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

[TR. 60] Q. Did you tell Mr. Santom about the agreement with Mr. Piccirillo?

A. No.

Q. Is there any reason why you didn't tell him about it?

A. No.

Q. You had the original of this in your **[TR. 61]** possession, isn't that correct?

A. That's right.

Q. But you didn't bring it with you to show it to the Marine bank at all?

A. No.

* * *

Daggett Exhibit #1

To: C. H. Bracken, Chairman and Chief Executive Officer
E. P. Junker, III, President

From: W. A. Hahn, Auditor - Fraud Control

Date: December 28, 1977

Subj: Columbus Packing Company Checking Account

1. Subject checking account, held at the Corry Office, has appeared on the overdraft report an excessive number of times in the past several months. Details of the account are as follows:

a. Name and Address of Account:
Columbus Packing Company
R. D. #1 Lottsville Road
Columbus, Pa.
b. Account Number: 1001-3029
c. Account Opened: May 7, 1976
d. Checks Returned: 17 (lifetime of account)
e. Number of times overdrawn: 189 (lifetime of account)
f. Current Balance: $9,345.03 Overdrawn
g. Currently Overdrawn Since: September 20, 1977

This account has been in an overdraft status almost constantly since April 1977 with an average overdrawn balance of approximately $9,000.

2. I have discussed the account on numerous occasions in the past with Corry management and was advised that an SBA loan was being processed which would resolve the overdraft problem. I further discussed the account with R. Santom this date for the first time since he assumed the position of Manager, Corry Area and was informed that he had discussed the account with R. Ross and T. Doolin and that ways and means to resolve the problem are currently being studied.

3. This memorandum is submitted for your information in view of the dollar amount and overdraft frequency of the account. I hold copies of the checking account statements from January through October 1977 for your review if desired.

W.A. HAHN

Copy to:
T. L. Doolin, Senior Vice President, Banking Division

R. N. Ross, Senior Vice President Northern/Southern Banking Regions
A. J. Cook, Vice President and Senior Auditor

Daggett Exhibit #2

COLUMBUS PACKING
BALANCE SHEET
OCTOBER 31, 1977

ASSETS

Curent assets:		
Accounts receivable		$ 12,009
Inventory		30,246
Prepaid insurance		1,000
Advance to employee		250
		43,505
Fixed assets: (note 1)		
Land	$ 30,000	
Buildings	73,000	
Equipment	33,911	
Trucks	11,583	
Leasehold improvement	2,344	
	150,838	
Reserve for depreciation	7,682	143,156
		$ 186,661

LIABILITIES & OWNER'S CAPITAL

Current liabilities:		
Bank overdraft		$ 15,711
Loan payable, bank		30,000
Accounts payable		21,197
Payroll taxes payable		8,897
Current portion of long-term debts		9,400
Loan - Individual		440
		85,645
Long-term debt: (note 3)		
Mortgage payable - Leonard Stockton	$ 70,000	
Mortgage payable - N. Burick	30,556	
Installment loans	13,689	
	114,245	

Less: portion payable within one shown as current liability	9,400	104,845
Accounts payable - prior owner		11,009
Owner's capital:		
Raymond Piccirillo, Capital		(14,838)
		$ 186,661

Exhibit A

Prepared from the records of the business without independent audit.

COLUMBUS PACKING
STATEMENT OF INCOME
FOR THE TEN MONTHS ENDED OCTOBER 31, 1977

	Total	Wholesale	Retail
Sales	$ 449,599	$ 423,044	$ 26,555
Less: Cost of goods sold	374,113	353,666	20,447
Gross Profit	75,486	69,378	6,108
Less expenses:			
Salaries	$ 49,587	$ 47,787	$ 1,800
Utilities	7,246	7,121	125
Office expense	498	498	
Interest	1,636	1,636	
Repairs & maintenance	1,835	1,735	100
Advertising	6,070	5,570	500
Supplies	927	767	160
Bad checks & bank charges	1,599	1,599	
Depreciation	3,700	3,600	100
Payroll taxes	3,391	3,241	150
Dues & subscriptions	110	110	
Delivery expense	3,016	2,716	300
Insurance	3,571	3,371	200
Property taxes	730	730	
Appraisal fees	384	384	
Miscellaneous	585	535	50
	84,885	81,400	3,485
Net income (loss)	$ (9,399)	$ (12,022)	$ 2,623

Exhibit B

( ) Denotes red figures.

Prepared from the records of the business without independent audit.

COLUMBUS PACKING
STATEMENT OF OWNER'S CAPITAL
FOR THE TEN MONTHS ENDED OCTOBER 31, 1977

Balance, January 1, 1977		$ 5,842
Less: Net loss for period ended October 31, 1977	$ 9,399	
Personal withdrawals	11,281	(20,680)
Balance, October 31, 1977		$ (14,838)

Exhibit C

( ) Denotes red figures.
Prepared from the records of the business without independent audit.

COLUMBUS PACKING
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR THE TEN MONTHS ENDED OCTOBER 31, 1977

Sources of working capital:		
Net income (loss)	$ (9,399)	
Add: Expenses not requiring an of working capital	3,700	$ (5,699)
Proceeds from installment loans		4,350
Reclassify prior owners accounts payable to long-term		13,200
		11,851
Uses of working capital:		
Leasehold improvements	$ 2,344	
Purchase of equipment	1,687	
Personal withdrawals	11,281	
Purchase of truck	5,360	
Payment on long-term debts	6,122	
Payments on long-term accounts payable	2,191	28,985
Increase (decrease) in working capital		$ (17,134)
Increase (decrease) in components of working capital		
Cash		$ (225)
Accounts receivable		5,775
Inventory		8,947
Prepaid insurance		(224)
Advances to employees		250
Bank overdraft		(15,711)
Loan payable, bank		(20,000)
Accounts payable		4,188
Payroll taxes payable		(4,894)
Current portion of long-term debt		200
Loan individuals		4,560
		$ (17,134)

Exhibit D

( ) Denotes red figures.

Prepared from the records of the business without independent audit.

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

   Inventories - are stated at the lower of cost or market, cost being determined on the first-in, first-out basis. Obsolete items are reduced to estimated net realizable values.

   Fixed assets - are carried at cost. Depreciation is calculated on the straight-line basis over the estimated useful lives of the assets.

2. Accounts payable - prior owner - were all assumed at the time the present owner purchased the business. Arrangements have been made with major creditors to repay the outstanding balances as cash is generated from profit during the forthcoming years.

3. Long-term debt:

   Mortgage payable, L. Stockton, 7¼ payable over fifteen years, secured by land, buildings and equipment.

   Mortgage payable, N. Burik, no interest, payable for first five years beginning in May, 1976. After five years monthly payments are to be made over a period of 7 years, and interest is to be computed at a rate of 7%.

   Installment loans, short term, truck, auto and personal loans mostly assumed from the prior owner, payable over a period of approximately three years.

Daggett Exhibit #3

Raymond A. Piccirillo Jr. 3/17/78
DBA Columbus Packing Company

$ 65,000.00	New Loan Proceeds
- 286.00	I/L Pay-off Marine
64,714.00	
- 10,312.32	Note - Pay-off Marine
54,401.68	
- 3,440.85	Note - Pay-off Marine
50,960.83	
- 20,999.44	Note - Pay-off Marine
29,961.39	
- 504.29	I/L Pay-off Judgement Consumer Loan (Associates)
29,457.10	
- 807.75	Judgement-Pay-off Nathaniel Arnot (hold check until settlement)
28,649.35	
- 5,146.75	Superior Meat Co. -Bal. in full
23,502.60	
- 3,474.00	George Hormel Co. -Bal. in full
20,028.60	
- 2,136.77	John Morrell Co. - Bal. in full
$ 17,891.83	
- 7,758.77	Deposit old A/C - For O.D.
$ 10,133.06	Deposit to new A/C - working capitol
	Take filing fees out of checking A/C.

The Memorandum and order of the United States District Court for the Western District of Pennsylvania granting the defendant's Motion for Summary Judgment is reproduced in the Petition for certiorari at pages A-25 through A-41.

The opinion of the Unied States Court of Appeals for the Third Circuit is reproduced in the Petition for Certiorari at pages A-1 through A-23.

The judgment of the United States Court of Appeals for the Third Circuit is reproduced in the Petition for Certiorari at page A-43.

The order of the United States Court of Appeals for the Third Circuit denying the petition for rehearing before the original panel is reproduced in the Petition for Certiorari at page A-44.

The order of the United States Court of Appeals for the Third Circuit denying the petition for rehearing in banc is reproduced in the Petition for Certiorari at page A-45.

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80-1562

Office-Supreme Court, U.S.
FILED
MAY 12 1981
ALEXANDER L. STEVAS,
CLERK

No. 80-152

IN THE

Supreme Court of the United States

October Term, 1980

MARINE BANK,

Petitioner,

vs.

SAMUEL WEAVER and ALICE WEAVER,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

ANDREW J. CONNER
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Batavia Times Publishing Co.
Batavia, N.Y. (716) 344-2000

Questions Presented

FIRST QUESTION:

Whether Weaver's pledge of his $50,000 Certificate of Deposit to Marine, for purposes of Weaver acquiring an investment position in Columbus, constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934.

SECOND QUESTION:

Whether Piccirillo's written promise to pay Weaver 50% of the profits of Columbus in consideration for Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine, was a security within §10b-5 of the Securities Exchange Act of 1934 and §17(a) of the Securities Act of 1933.

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IN THE

Supreme Court of the United States

October Term, 1980

No. 80-152

MARINE BANK,

Petitioner,

vs.

SAMUEL WEAVER and ALICE WEAVER,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Counterstatement of Facts

Samuel and Alice Weaver, hereinafter referred to as "Weaver", claim that Marine Bank, hereinafter referred to as "Marine", induced Weaver to become involved in an investment or securities transaction as a consequence of material misrepresentations intentionally made by Marine to Weaver to induce Weaver's involvement. The subject matter of this claim relates to what both Weaver and Marine considered as a $50,000.00 investment by Weaver in a wholesale slaughterhouse and retail meat store operated by Columbus Packing Company, hereinafter referred to as "Columbus."

Columbus was a proprietorship operated by Raymond and Barbara Piccirillo. From May of 1976 through December of 1977, Marine made three separate loans to Columbus in the amounts of $10,000.00; $20,000.00; and $3,350.00 for a total of $33,350.00. Columbus was unable to make the principal and interest payments on these loans at all material times in 1977 and 1978. Columbus was insolvent at all material times from October of 1977 through March 17, 1978. As of December of 1977, Columbus's checking account had been overdrawn 189 times since May 7, 1976 and was overdrawn in the amount of $9,345.02 as of that date. That checking account remained continuously overdrawn through March 17, 1978.

In late 1977 and early 1978, Marine had exhausted all its rights as the commercial banker for Columbus to either collect its loans from Columbus and/or to correct the overdrawn checking account of Columbus. In September of 1977, the United States Small Business Administration refused to loan Columbus any money for working capital. When Marine made loans to Columbus, it intended to perfect its position through Uniform Commercial Code filings against Columbus's equipment. However, because it failed to properly file its liens, it could not sell the Columbus equipment to satisfy these loans.

In February and March of 1978, Weaver was approached by both Piccirillo and Marine representatives responsible for the Columbus account to invest in Columbus. Sam Weaver, then aged 79, and Alice Weaver, 71, were farmers. Since 1976, they had conducted a livestock auction in Union City, Erie County, Pennsylvania. They had

no formal education beyond the 8th Grade. They had little or no interest in making any investment in Columbus until being solicited to do so by Piccirillo and the representatives of Marine.

Weaver, on February 28, 1978, had withdrawn $50,000.00 from another bank and purchased a $50,000.00 Certificate of Deposit at Marine for investment purposes and possibly as working capital for his livestock business. This Certificate had a maturity date of six years with interest at 6%. Piccirillo and Marine were aware of Weaver having this $50,000.00 Certificate of Deposit and Marine persuaded Weaver to pledge this $50,000.00 Certificate of Deposit to Marine on the representation that Marine would make a $65,000.00 loan to Columbus and that all and/or substantially all of the $65,000.00 loan would be made available to Columbus for working capital. Marine also represented that Marine had an adequate collateral position on Columbus's equipment to protect Weaver's $50,000.00 Certificate of Deposit and that Marine would provide Weaver with a monthly profit and loss statement of Columbus so that Weaver could monitor his investment. Marine failed to disclose to Weaver that Columbus was insolvent; that Columbus had failed to make the interest and principal payments on the prior loans; that Columbus's checking account was in a continuous overdrawn position from 1977 through March 17, 1978; that Columbus would continue to be insolvent after Marine made this $65,000.00 loan; and that very little of this money would be available to Columbus for working capital.

Weaver pledged his $50,000.00 Certificate of Deposit to Marine on March 17, 1978. Marine made the $65,000.00 loan to Columbus on that date. On the same

day, Weaver, as consideration for pledging the $50,000.00 Certificate of Deposit to Marine, executed a written agreement with Columbus which gave Weaver the right, among other things, to receive 50% of the "adjusted net profits" of Columbus so long as the Certificate of Deposit remained pledged to Marine. Marine was not specifically aware of the terms of the agreement which Weaver executed with Columbus on March 17, 1978, but Marine's officers handling this transaction testified in their pre-trial deposition that they considered Weaver as an investor in Columbus and that the amount of his investment was the $50,000.00 which he pledged on March 17, 1978.

On March 17, 1978, Marine distributed the proceeds of the $65,000.00 loan by paying $12,068.56 to various creditors of Columbus who had put Marine on notice of claims; $42,978.38 to itself to cover the three past loans and the accrued interest; $7,758.77 to itself to reimburse the overdraft position on Columbus's checking account. The remaining $10,133.06 was distributed to Columbus. However, an IRS lien of $6,300.00 had to be satisfied out of this distribution, leaving $3,833.06 available to Columbus for working capital. Because Columbus was insufficiently capitalized and because of its insolvency, both before and after this loan, Columbus filed bankruptcy proceedings in May of 1978.

In the bankruptcy proceedings involving Columbus, Marine is a general creditor with regards to the $65,000.00 loan. Marine refuses to return the $50,000.00 Certificate of Deposit to Weaver even though requested to do so.

In the District Court, Weaver claimed that he was the seller and Marine was the purchaser of the $50,000.00 Certificate of Deposit as a consequence of the pledge of that Certificate of Deposit on March 17, 1978. Weaver also claimed that he was the purchaser of a security and/or investment contract when he entered into the March 17, 1978 agreement with Columbus to share in the profits of Columbus and that if Marine was not a seller of that security, they were liable in a secondary capacity in the sale of that security to Weaver. Three separate theories of liability were set forth in the pleadings by Weaver against Marine including allegations that Marine (1) violated §10(b) of the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 891, 15 USC §78j(b); (2) that Marine violated §17(a) of the Securities Act of 1933, 48 Stat. 84, 15 USC §77q(a); and (3) that Marine violated the Pennsylvania Securities Act, Pa. Stat. Ann. Tit. 70, §1-101 *et seq.* (Purdon Supp. 1980).

At the conclusion of discovery and prior to trial, Marine moved the District Court for a Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. The District Court granted same, holding that there was no genuine issue of fact supporting the claim that Weaver was either a purchaser and/or a seller of a security and/or that Marine was involved in the purchase and/or sale of securities as defined by the applicable Federal law. The Court also dismissed the pendant State Court claims. The Third Circuit Court of Appeals reversed and remanded the case to the court below holding, in summary, that the Weavers were entitled to a trial on the three theories of liability as outlined above.

REASONS FOR DENYING THE WRIT

FIRST QUESTION:

Whether Weaver's pledge of his $50,000 Certificate of Deposit to Marine, for purposes of Weaver acquiring an investment position in Columbus, constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934.

Weaver claimed that the pledge of his $50,000 Certificate of Deposit to Marine on March 17, 1978 constituted the purchase by Marine and sale by Weaver of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934. Upon Motion by Marine, the District Court granted Marine Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure holding, in summary, that there was no genuine issue of fact which would support a finding that this pledge constituted the purchase and sale of a security within either Act. In reversing, the Third Circuit held that there was a genuine issue of material fact as to whether or not this pledge constituted a purchase and sale of a security under either of these Acts.

In its Petition for Writ of Certiorari to this Court, Marine claims that the Third Circuit's holding that the pledge of a Certificate of Deposit could be found to be a purchase and sale of a security was contrary to holdings in the 4th, 5th, 7th and 9th Circuit Court of Appeals. All of the authorities relied upon by Marine were decided prior to the Court's decision in *Rubin v. U.S.*, _____ U.S. _____, 100 S. Ct. 698, 66 L.Ed. 2d 633 (1981).

In *Rubin v. U.S., supra,* the Court held that a pledge of worthless common stock to a bank for a commercial loan constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933. In *Rubin v. U.S., supra,* common stock was pledged. In the present case, a six-year Certificate of Deposit was pledged. The 5th Circuit's holding in *McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 (5th Cir., 1974), relied upon by the Marine as a holding contrary to the 3rd Circuit's holding in the present case, is now controlled by the holding of *Rubin v. U.S., supra,* in that the Court in *McClure v. First National Bank of Lubbock, Texas* held that a pledge of a security without a foreclosure on the pledge did not constitute the purchase and sale required by the Act. 497 F. 2d at pages 495, 496.

Weaver claims that he was exchanging a relatively safe investment position in a six-year Certificate of Deposit for a speculative investment position in Columbus. He claims further that the pledge of this Certificate of Deposit was in substance a purchase by Marine and sale by Weaver. It was highly unlikely that Columbus, insolvent both before and after this transaction, could repay the loan which resulted from this pledge. It was only if that loan was repaid that Marine would return this Certificate of Deposit to Weaver. Considering that as of March 17, 1978, there was little likelihood that Weaver would recover his Certificate of Deposit from Marine, Weaver's pledge of this Certificate of Deposit constituted the sale of one investment in exchange for an investment position in Columbus. Weaver was receiving no other consideration for his pledge other than an investment position in Columbus.

Other authorities relied upon by Marine in support of its proposition that the 3rd Circuit's holding is in conflict with the holdings of other Circuits are clearly distinguishable upon their facts from the present case. In *Burrus, Cootes and Burrus v. MacKethan*, 537 F.2d 1262 (4th Cir., 1976), Certificates of Investments were not pledged or exchanged by a party who was intending to make an investment in a common venture and/or a party who was exchanging one investment position for another. In *Bellah v. First National Bank, et al.*, 495 F.2d 1109 (5th Cir., 1974) at page 1116, the 5th Circuit held that the record before the Court was not adequate for that Circuit to determine whether or not the Certificate of Deposit involved the purchase and sale of a security. It therefore remanded that case to that District Court in the same fashion that the 3rd Circuit remanded this case to the Court below.

In *Canadian Imperial Bank of Commerce Trust Company v. Fingland*, 615 F.2d 465 (7th Cir., 1980), the 7th Circuit held that the purchase of a Certificate of Deposit which did not involve an investment in a common enterprise did not constitute a purchase and/or sale of a security. Weaver is not contending that the original purchase of his Certificate of Deposit from Marine two weeks prior to March 17, 1978 constituted the purchase and sale of a security within these Acts but, rather, contends that it was the exchange of his investment in this Certificate of Deposit, by way of this pledge, for investment purposes which categorizes this pledge as a purchase and sale of a security within either of the Securities Act of 1933 and/or the Securities Exchange Act of 1934.

A "substance over form" analysis was followed by the 7th Circuit in *C.N.S. Enterprises, Inc. v. G & G Enterprises, Inc.*, 508 F.2d 1354 (7th Cir., 1975) for purposes of determining whether or not the purchase and sale of an instrument issued by commercial banks involved a purchase and sale of a security within these Acts. Following a substance over a form analysis, and considering that all of the facts in the present case were to be construed in favor of Weaver on a Motion for Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure, the 3rd Circuit in the present case had to accept the evidence that Weaver was exchanging one investment position for another by this transaction. The Marine officers directly involved in soliciting Weaver's pledge testified that they considered Weaver as making a $50,000.00 investment in Columbus by virtue of this March 17, 1978 transaction.

In *Amfac Mfg. Corp. v. Arizona Mall of Tempe*, 583 F.2d 426 (9th Cir., 1978), the 9th Circuit held that a mortgage company giving a promissory note was not making an investment of risk capital because there was no expected return which was dependent upon the entrepreneurial efforts of another. However, in the present case, return of Weaver's Certificate of Deposit by Marine was entirely contingent upon the entrepreneurial efforts of Piccirillo. If Piccirillo was able to generate a profit from the pooling of his assets and the working capital which Marine was allegedly loaning to Columbus as a consequence of Weaver's pledge, then Weaver's Certificate of Deposit would have been returned. Unless Columbus generated a profit, there was no other way in which Weaver's Certificate of Deposit would be returned.

The definition of security in the Securities Act of 1933 and in the Securities Exchange Act of 1934 is extremely broad. The Securities Exchange Act of 1934 specifically includes Certificates of Deposits of the type involved in this transaction, except those whose maturity at the time of the issuance does not exceed nine months. The Certificate of Deposit pledged in the present case had a six-year maturity. There is no authority in any of the Circuits that holds that a pledge of a six-year Certificate of Deposit held for investment purposes and pledged for investment purposes is not a purchase and sale of a security within these Acts.

The anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 were designed to protect investors. *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *S.E.C. v. W.J. Howey*, 328 U.S. 293 (1946). There is substantial evidence in the record to support the contention that Weaver, at the time that he was pledging this Certificate of Deposit to Marine, was participating in an investment transaction as opposed to a commercial banking transaction. The 10th Circuit in *Zabriskie v. Lewis*, 507 F.2d 546 (10th Cir., 1974), in holding that a promissory note, stock certificate, and hypothication agreement were securities protected by these Acts, focused upon the purpose of the transaction from the standpoint of the investor. 507 F.2d at pages 551 and 552. Marine's officers and Weaver believed Weaver was making an investment in Columbus by virtue of this pledge.

A pledge of a security to a bank for investment purposes constitutes the purchase and sale required by these Acts. *Rubin v. U.S., supra.* The six-year Certificate of Deposit falls within the definition of security for both Acts. Other courts have found liability under similar circumstances. *Zabriskie v. Lewis, supra.*

SECOND QUESTION:

Whether Piccirillo's written promise to pay Weaver 50% of the profits of Columbus in consideration for Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine, was a security within §10b-5 of the Securities Exchange Act of 1934 and §17(a) of the Securities Act of 1933.

Contemporaneous with Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine on March 17, 1978, and in consideration for this pledge, Piccirillo agreed in writing to, among other things, pay Weaver 50% of the profits of Columbus so long as the $50,000.00 Certificate of Deposit remained pledged to Marine. Weaver claimed that this written agreement to share the profits in Columbus was a security. Weaver further claimed that Marine made material misrepresentations which induced his purchase of this security.

The definition of security within the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), is essentially the same as the definition of security in the Securities Act of 1933, 15 U.S.C. §77(b)(1). The District court held as a matter of law that this profit sharing agreement was not a security. The Third Circuit reversed, holding that it was both a certificate of interest or profit sharing agreement within *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *S.E.C. v. C.M. Joiner Leasing Company*, 320 U.S. 334, 351 (1943) and/or that it could be found to be an investment contract as defined by the Court in *S.E.C. v. W.J. Howey Company*, 328 U.S. 293 (1946); *Cameron v. Outdoor Resorts of America*, 608 F.2d 187 (5th Cir., 1979).

Marine, in their Petition for Certiorari, never challenged the Third Circuit's holding that this agreement could be found to be a certificate of interest and/or a profit

sharing agreement within the holding of *Tcherepnin v. Knight, supra*, 389 U.S. at pages 338, 339. Other courts on similar facts have found such an agreement to be a certificate of interest and/or a profit sharing agreement, *S.E.C. v. Addison*, 194 F.Supp 709, 721-722 (N.D. Tex., 1979). There are sufficient facts which would allow a jury to find that Weaver's right to receive 50% of the future profits of Columbus constituted a profit sharing agreement and hence a security which is protected by both the 1933 and 1934 Acts. *Tcherepnin v. Knight, supra.*

Marine challenges the alternative holding of the Third Circuit that this profit sharing agreement could be found to be an investment contract. In *S.E.C. v. W.J. Howey Company, supra*, the Court held that an investment contract, to constitute a security protected by the 1933 and 1934 Acts, required: (1) an investment of money; (2) an investment of money into a common enterprise; (3) with profits and/or the expectation of profits resulting from the efforts of others. This definition of an investment contract has been followed and applied by various Circuits in finding that a profit sharing agreement constitutes an investment contract, *Cameron v. Outdoor Resorts of America, supra*, 608 F.2d at pages 192, 193 and/or that an agreement is not an investment contract, *Lino v. City Investing Co.*, 487 F.2d 683 (3rd Cir., 1973) at pages 691 and 692.

Considering that the Bank officials responsible for this transaction testified that Weaver was considered an investor in Columbus and that they considered his pledge of the $50,000.00 Certificate of Deposit to Marine as the amount of his investment in Columbus, Marine cannot seriously challenge the proposition that Weaver made an investment of money and/or the first element required by

S.E.C. v. W.J. Howey Company, supra. Marine claims Weaver did not make an investment into a common enterprise and that the profits, and/or expectation of future profits would not result from the efforts of others.

The holdings relied upon by Marine for the proposition that the Third Circuit's opinion in the present case is in conflict with holdings of other Circuits are clearly distinguishable on their facts. The Seventh, Third and Fifth Circuits in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir., 1977); *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir., 1972), *cert. denied*, 409 U.S. 887 (1972); *Wasnowic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D. Pa. 1972), *affirmed mem.*, 491 F.2d 752 (3rd Cir., 1973), *cert. denied*, 416 U.S. 994 (1974); and *S.E.C. v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir., 1974) respectively, were considering whether or not commodity future contracts and/or margin agreements with respect to these contracts constituted a security. In each of these commodity contracts there was no pooling of assets. The chance to make future profits was not dependent upon the combination of any other parties' capital or labor with an investor's capital.

In the present case, Weaver's right to receive profits was dependent upon the combination of Weaver's investment and/or the working capital which he was injecting into Columbus by virtue of these transactions with Piccirillo's labor and assets. In effect, there was a pooling of Weaver's capital with Piccirillo's equipment and labor which was expected to produce profits in the future. Weaver could not recover his $50,000.00 Certificate of Deposit or investment, unless Columbus generated a profit to repay the loan to Marine resulting from Weaver's pledge of this Certificate of Deposit.

In *Great Western Bank and Trust Co. v. Kotz*, 532 F.2d 1252 (9th Cir., 1976), additional authority relied upon by Marine, the facts are clearly distinguishable from the present case. That claim involved a corporate note given to a bank for a 10 month line of credit. There was no agreement whatsoever to share profits. There was no investment like Weaver was making into Columbus, the return on which was contingent upon the combination of capital and labor producing profits.

Marine claims that Weaver's expectation of profits was not dependent upon the "efforts of others" within *S.E.C. v. Howey, supra.* There was no evidence that Weaver was required and/or expected to perform any labor and/or services on behalf of Columbus. At age 79, it would have been unrealistic to expect Weaver to have made any substantial efforts on behalf of Columbus. Even if it could be implied that Weaver was to render nominal services on behalf of Columbus, this would not preclude a finding that this was an investment contract. See *Lino v. City Investing Co., supra* at 487 F.2d page 692.

Marine also claims (because there was no advertising, public interest or public offering), that a private agreement to share the profits of a business in consideration for a $50,000.00 investment is not a security within either the 1933 and/or 1934 Act. Prior authority has established that claims under these Acts may be established in private face-to-face transactions providing there has been a purchase and sale of a security affecting interstate commerce. *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir., 1960); *Superintendent of Insurance v. Bankers Life and Casualty Company*, 404 U.S. 6 (1971); *Affiliated UTE Citizens v. United States*, 406 U.S. 128 (1972).

Marine also claims that Marine had no knowledge of the Piccirillo agreement with Weaver and the Third Circuit failed to require Weaver to allege scienter and/or allege an intention to deceive in violation of the Court's holding in *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976).

Marine recognized that Weaver was an investor in Columbus and that the pledge of his Certificate of Deposit represented an investment transaction. Weaver alleged in his complaint and supporting affidavit that "in connection with" that investment transaction, Marine made several misrepresentations to induce Weaver to invest in Columbus even though Marine had actual knowledge, not disclosed to Weaver, that Columbus was insolvent both before and after the March 17, 1978 transactions. A fact finder could easily conclude that the misrepresentations made by Marine were intentional and designed to secure Weaver's $50,000.00 Certificate of Deposit so that Marine could satisfy their outstanding and unpaid loans with Columbus and satisfy the longstanding overdraft of Columbus's checking account for which there was no remedy from the standpoint of Marine other than an investment of capital into Columbus. Weaver is not claiming that Marine acted negligently, but rather claims that they intentionally defrauded him out of his $50,000.00 Certificate of Deposit and all of the above facts satisfy the scienter requirements set forth in *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976).

The Third Circuit's holding in the present case will have little or no impact on the banking industry to the extent that the banks engage in traditional banking transactions. The transactions which give rise to the present case and holding are not traditional commercial

banking transactions but rather are investment transactions. Marine actively involved itself in soliciting Weaver to make an investment in Columbus because traditional banking procedures had failed to remedy the failure of Columbus to repay Marine as required and the failure of Marine to properly protect itself in extending its line of credit to Columbus. When banks become actively involved in investment transactions, and make material misrepresentations with respect thereto, they become liable under either the 1933 and/or 1934 Act. *Affiliated UTE Citizens v. United States*, at 406 U.S. at pp. 152, 153.

Conclusion

The decision of the Third Circuit that the pledge of Weaver's $50,000.00 Certificate of Deposit to Marine created a genuine issue of material fact as to whether the transaction constituted a purchase and sale of a security under the 1933 and 1934 Acts is consistent with this Court's most recent decision in *Rubin v. U.S., supra.*

The holding of *Rubin v. U.S.* not cited by Marine, controls and disposes of the first question presented, namely that the pledge of the Certificate of Deposit for the loan constitutes the purchase and sale of a security under the Securities Acts.

There is substantial record evidence to support the Third Circuit's conclusion that the Piccirillo agreement was a security either because it met the definitions of a profit sharing agreement as defined by *Tcherepnin v. Knight, supra*, and *C.M. Joiner Leasing Company, supra*, and/or it satisfied the three elements of an investment contract as explained in *S.E.C. v. W.J. Howey Company*,

supra. It is conceded by Marine at this stage of the proceedings that Weaver was a purchaser of the Piccirillo agreement and that Marine made material misrepresentations that induced its sale.

Lastly, the cases cited by Marine for the proposition that the decisions of the Circuit Court are in conflict on both questions can be reconciled by a close scrutiny of the factual patterns of each, particularly in light of this Court's decision in *Rubin v. U.S.*

Respectfully submitted,

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No. 80-1562

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK
Petitioner

v.

SAMUEL WEAVER and ALICE WEAVER
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR PETITIONER

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CERTIORARI GRANTED JUNE 1, 1981

QUESTIONS PRESENTED FOR REVIEW

1. Is an FDIC-insured certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5.

2. Unknown to the lending bank, as consideration for acting as guarantors on a business loan, an agreement was signed between the primary obligors and the guarantors giving the guarantors:

(a) the right to use the barn and pasture of the business;
(b) the right to receive 50% of the "adjusted net profits" of the business so long as they remained co-obligors;
(c) the right to receive $100 per month until repayment of the loan; and
(d) the right to veto any future loans to the business; thereby raising the question whether this agreement is a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5 and, if a security, whether the bank can be held liable.

PARTIES

The caption of the case contains the names of all parties to the proceeding before the United States Court of Appeals for the Third Circuit.

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(a) THE RIGHT TO USE THE BARN AND PASTURE OF THE BUSINESS;

(b) THE RIGHT TO RECEIVE 50% OF THE "ADJUSTED NET PROFITS" OF THE BUSINESS SO LONG AS THEY REMAINED CO-OBLIGORS;

(c) THE RIGHT TO RECEIVE $100 PER MONTH UNTIL REPAYMENT OF THE LOAN; AND
(d) THE RIGHT TO VETO ANY FUTURE LOANS TO THE BUSINESS; THE AGREEMENT IS NOT A "SECURITY" AS DEFINED IN THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES AND EXCHANGE COMMISSION'S RULE 10b-5 AND, IF A SECURITY, THE BANK CANNOT BE HELD LIABLE.....21

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REPORTS

The opinion of the United States Court of Appeals for the Third Circuit is reported at *Weaver v. Marine Bank*, 637 F.2d 157 (3rd Cir. 1980). It is reproduced in the Petition for Certiorari at pages A-1 through A-23.

The judgment of the United States Court of Appeals for the Third Circuit is reproduced in the Petition for Certiorari at page A-43.

The orders of the United States Court of Appeals for the Third Circuit denying the petition for rehearing before the original panel and for rehearing in banc is reproduced in the Petition for Certiorari at pages A-44 and A-45, respectively.

The memorandum and order of the United States District Court for the Western District of Pennsylvania granting defendant's Motion for Summary Judgment has not been printed in any official reports. It is reproduced in the Petition for Certiorari at pages A-25 through A-41.

JURISDICTION

The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. § 1254(1). The petition for writ of certiorari was filed March 13, 1981, within ninety days of the orders of the Third Circuit denying the petition for rehearing before the original panel and before the court in banc, entered January 26, 1981, as required by 28 U.S.C. § 2101 (c) and Supreme Court Rule 20.

STATUTES AND REGULATIONS INVOLVED

Securities Act of 1933, 15 U.S.C. § 77b (1):

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or sub-

scription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Act of 1933, 15 U.S.C. § 77q(a):

§ 77q. Fraudulent interstate transactions

(A) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Securities Exchange Act of 1934, 15 U.S.C. 78c(a) (10):

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the

foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Securities Exchange Act of 1934, 15 U.S.C.§ 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This case is a suit brought by the guarantors of a commercial loan, Samuel and Alice Weaver, against Marine Bank, the lender. The loan was made on March 17, 1978, in the principal amount of $65,000 to Columbus Packing Company, a proprietorship consisting of a wholesale slaughterhouse and retail meat store owned by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo. (J.A. 32-37).

Some time prior to the loan closing on March 17, 1978, Raymond and Barbara Piccirillo and the Weavers had entered into an agreement which provided that as consideration for Weavers acting as co-obligors on the loan. Weavers were given the following rights:

1) to use the barn and pasture on the slaughterhouse premises;
2) to receive 50% of the "adjusted net profits" of Columbus Packing so long as Weavers remained as co-obligors;
3) to receive $100 per month until the loan was repaid; and
4) to veto any future loans to Columbus Packing. (J.A. 11-12; J.A. 62).

The bank was never informed of this agreement or its contents. (J.A. 20-38; J.A. 62-63; J.A. 64).

On March 17, 1978, the bank loaned Raymond and Barbara Piccirillo, doing business as Columbus Packing, the sum of $65,000. A $65,000 demand note was signed by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo d/b/a/ Columbus Packing Company and was co-signed by Raymond A. Piccirillo and Mary T. Piccirillo. (J.A. 32-37). Samuel and Alice Weaver executed an agreement of guaranty which guaranteed payment of the principal debtors to a maximum of $50,000. (J.A. 26-29). Collateral for the loan included the pledge by Samuel and Alice Weaver of a $50,000 certificate of deposit issued by Marine Bank. (J.A. 30-31; J.A. 24-25). This certificate of deposit, bearing a due date of February, 1984, had been previously purchased by the Weavers on February 28, 1978 at the Corry, Pa. branch of Marine Bank, not for the purpose of using it in the Piccirillo transaction, but rather for the purpose of having money nearby for the operation of their livestock auction which they operated in that area. (J.A. 44, par. 3 and 4; J.A. 62). Columbus Packing filed bankruptcy on July 21, 1978. (J.A. 7, par. 16).

The Weavers filed a complaint, the basis for federal jurisdiction being an alleged violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). (J.A. 4-12). The document alleged to be a security in the complaint was the "Piccirillo agreement" set forth above. (J.A. 5, par. 7; J.A. 11-12). The bank filed a motion for summary judgment. (J.A. 19). In their answer to the bank's motion for summary judgment, the Weavers alleged that there was an issue of fact as to whether the bank violated the "1934 Securities and Exchange Act and Section 17(a) of the 1933 Securities and Exchange Act" (error in original) and also raised the issue that the certificate of deposit was a security. (J.A. 39). The district court dismissed the action for lack of jurisdiction, holding that no purchase or sale of a security was involved. (Pet. for certiorari, A.25 - A.41).

After summary judgment was granted, the Weavers filed a motion to amend the complaint to include an allegation regarding the 1933 Securities Act and regarding the certificate of deposit. The motion was denied. (Pet. for certiorari, A.42).

The Weavers did not appeal the district court's order denying the motion to amend the complaint, but did appeal the grant of summary judgment.

A three-judge panel of the court of appeals, with one judge dissenting, reversed, holding that both the certificate of deposit and the agreement constituted "securities" under both the 1933 and 1934 Acts. (Pet. for certiorari, A.1 - A.23). A petition for rehearing was denied by the same three-judge panel, and a petition for rehearing in banc was denied by a majority of the circuit judges with two dissents. (Pet. for certiorari, A.44-A.45).

SUMMARY OF ARGUMENT

I. An FDIC-insured certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is not a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5. The language of the statutes does not refer to certificates of deposits issued in exchange for currency. A certificate of deposit does not meet the test for an investment contract under the 1933 Securities Act as set forth in *SEC v. W. J. Howey Co.* and as extended to the 1934 Securities Exchange Act in *Tcherepnin v. Knight*, which test requires "a common enterprise with profits to come solely from the efforts of others" because it is payable in dollars at a fixed date at a fixed rate of interest regardless of the bank's profitability.

Three federal courts of appeals and numerous district courts have concluded that bank certificates of deposit do not constitute investment contracts under either Act.

The certificate of deposit is not a "note" as contained in the definition of a security simply because it matures in more than nine months. The transaction is commercial, not investment, in nature.

The legislative history of the Securities Acts infers that Congress did not intend bank certificates of deposit to be included as "securities." The contemporaneous passage of the Glass-Steagall Banking Act and the Federal Deposit Insurance Act mitigates against extension of the Securities Acts to such documents. To treat a certificate of deposit as a security will superimpose on existing federal and state regulatory schemes a second pattern of regulations by the Securities and Exchange Commission, and will extend federal court jurisdiction to routine banking transactions in which an instrument constituting evidence of interest payable is issued in return for a currency deposit.

II. The "Piccirillo Agreement" does not constitute an "investment contract" or a "profit-sharing agreement" under the *Howey* and *Tcherepnin* tests for a security because it does not include multiple investors, there is no pooling of funds, the success of the business arrangement is not totally dependent upon the skills of the business

owner (Piccirillo), and there was no advertisement or public offering. It was rather a tailor-made contract between two local men engaged in the cattle business, with personal benefits for both.

Even if the Piccirillo agreement were a "security", the bank cannot be held liable under SEC Rule 10b-5 because the bank did not know the agreement existed. Therefore, the alleged misstatements of the bank were not "in connection with" the agreement. The bank must have knowledge of the illegal scheme at the time it loaned the money and knowingly render substantital assistance to the scheme to be held liable under 10b-5. While the legality of the alleged bank conduct may be determined under many federal and state statutes or common law, Rule 10b-5 should not be extended so as to make banks the insurers of the actions of their debtors in the course of routine commercial transactions.

ARGUMENT

I. AN FDIC-INSURED CERTIFICATE OF DEPOSIT, BEARING A FIXED RATE OF INTEREST AND ISSUED BY A COMMERCIAL BANK IS NOT A "SECURITY" AS DEFINED IN THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES AND EXCHANGE COMMISSION'S RULE 10b-5.

The Weavers have alleged a violation of the antifraud provisions of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10b-5. The Weavers have also attempted to allege a violation of the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. § 77q(a).[1] These sections generally prohibit engaging in fraud in connection with the

1. The complaint filed in this case did not allege a violation of the Securities Act of 1933, 15 U.S.C. § 77q(a), nor did it allege that the pledge of the certificate of deposit was a "security." It alleged only a violation of the Securities Exchange Act of 1934, 15 U.S.C. § 17j(b), based upon the "Piccirillo Agreement." (J.A. 4-12). In the Weaver's answer to the bank's motion for summary judgment, the Weavers alleged that there was an issue of fact as to whether the bank violated the "1934 Securities and Exchange Act and Section 17(a) of the 1933 Securities and Exchange Act [sic]" and also raised for the first time the issue of the certificate of deposit as a security. (J.A. 39). The opinion of the district court discussed both statutes. (Pet. for Cert. A.25-A.41). After summary judgment was granted, the Weavers filed a motion to amend the complaint to include an allegation regarding the 1933 Securities Act and regarding the certificate of deposit. This motion was denied by the district court on the ground that under F.R.C.P. 56, all theories of liability advanced by the Weavers had "been considered and will be before the Court of Appeals." (Pet. for Cert. A.42). The Weavers did not appeal from the district court's order denying the motion to amend the complaint, but briefed the issue of the 1933 Securities Act and the certificate of deposit before the Third Circuit. The Third Circuit's opinion, which squarely decided the certificate of deposit issue, appears to be based on the Securities and Exchange Act of 1934. (Pet. for Cert. A.2-A.14). However, the Third Circuit noted in a footnote that the Weavers had alleged a 1933 Act violation in the motion to file an amended complaint, and in a subsequent footnote stated that the definition of a security in the 1934 Act "as is here relevant... is essentially the same as in §2(1) of the Securities Act of 1933...". (Pet. for Cert. A.2, n.1; A.5, n.2). The Third Circuit did not properly have the issue of the 1933 Securities Act or the issue of the certificate of deposit as a "security" before it, there having been no appeal from the district court's denial of the motion to amend the complaint. However, because of the Third Circuit's apparent decision that (1) the certificate of deposit is a security and (2) it is a security for purposes of *both* Acts, the bank presented both questions for review. (Pet. for Cert. i).

purchase or sale of a security. It is the position of the Marine Bank that the bank "certificate of deposit" is not a "security" as defined in that Act.

A copy of the instrument was not incorporated into the Weaver's complaint, but the essential terms and characteristics of the certificate of deposit appear in the record.

In return for a deposit of $50,000 by the Weavers on February 28, 1978, the certificate of deposit was issued by the Corry branch of the Marine Bank, an FDIC insured banking institution, in the amount of $50,000. (J.A. 41; J.A. 44). It is a six year certificate of deposit, due in February of 1984, and bearing the fixed rate of interest payable at that time. (J.A. 41; J.A. 24; J.A. 30; J.A. 58). The certificate of deposit was purchased by the Weavers for the purpose of having money nearby for the operation of their livestock auction which they operated in that area. (J.A. 41).[2] On March 17, 1978, the Weavers acted as guarantors of a loan by Marine Bank to Raymond A. and Barbara J. Piccirillo, d/b/a Columbus Packing Company. The note evidencing the loan was in the amount of $65,000 and was co-signed by Raymond A. and Mary T. Piccirillo, Sr., the parents of Raymond. The Weavers, as guarantors, signed a guaranty agreement limited to the amount of $50,000. As collateral for the guaranty agreement, the Weavers pledged and assigned the $50,000 Marine Bank certificate of deposit.

To determine whether the Securities Acts apply to the pledge of this bank certificate of deposit, the starting point is the language of the statute itself. *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551 at 558 (1979). The definition of "security" does not specifically list certificates representing currency deposits, but refers only to a

2. In the recitation of facts contained in the opinion of the Third Circuit, the impression is given that the certificate was both purchased and pledged to secure the Piccirillo loan on March 17, 1978. (Pet. for Cert. A.3). This is incorrect. As stated in the affidavits submitted by the Weavers in response to the bank's motion for summary judgment, the certificate was purchased on February 28, 1978, so that the Weavers would have a deposit close to the livestock auction they had purchased in October of 1977. (J.A. 41; J.A. 62.). The Weavers contend that at that time they "had no investment interests whatsoever in the business known as the Columbus Packing." (J.A. 41, par. 4). They did not pledge the certificate to Marine Bank as collateral for the Piccirillo loan until March 17, 1978, at which time the Weavers contend the certificate assumed the characteristics of a "security" under the Securities Acts. (J.A. 39).

"certificate of deposit, for a security."[3] This language refers to instruments issued by security holders' protective committees in the course of corporate reorganizations and has been construed not to include a certificate of deposit issued in exchange for currency. *Canadian Imperial Bank of Commerce v. Fingland*, 615 F.2d 465 (7th Cir. 1980); *Burrus, Cootes and Burrus v. MacKethan*, 537 F.2d 1262 at 1264, *withdrawn as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977); *Superintendent of Insurance of State of New York v. Banker's Life & Casualty Co.*, 300 F. Supp. 1083 at 1099 (S.D.N.Y. 1969), *aff'd* 430 F.2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U.S. 6 (1971); *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 at 31 (S.D.N.Y. 1968), *aff'd on other grounds*, 435F.2d 510 (2d Cir. 1970); H.R. Report No. 85, 73rd Cong., 1st Session, 1933, Section III 2. Section 3(a) (10), in referring to a "certificate of deposit, for a security," can further be construed to imply the negative; that is, a certificate of deposit issued for currency is excluded. *Burrus*, 537 F.2d at 1265.[4] The omission of any reference to pension plans in the definition of "security" was considered significant by this Court in *Daniel* where it stated:

> In spite of the substantial use of employee pension plans at the time they were enacted, neither § 2(1) of the Securities Act nor § 3(a) (10) of the Securities Exchange Act, which defines the term "security" in considerable detail and with numerous

3. The 1933 Act refers to "certificate of deposit for a security" without the comma. However, the definition of security in Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1) is virtually identical and the coverage of the two acts is considered the same. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847 n. 12 (1975); *Tcherepnin v. Knight*, 389 U.S. 332, 342 (1967). As noted in *Tcherepnin*, the definition of security in the 1934 Act was intended to be "substantially the same as [that contained] in the Securities Act of 1933." S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934). The major difference between § 10(b) of the 1934 Act and § 17(a) of the 1933 Act is that while an implied cause of action exists under § 10(b), this Court has never decided whether a private cause of action exists under § 17(a) of the 1933 Act. *Aaron v. SEC*, 446 U.S. 680 at 689 (1980).

4. The Proposed Official Draft of the Federal Securities Code of the American Law Institute specifically excludes from the definition of "security" . . . "A bank certificate of deposit that ranks on a parity with an interest in a deposit account with the banks." The Proposed Official Draft of the Federal Securities Code, dated March 15, 1978.

examples, refers to pension plans of any type. *International Brotherhood of Teamsters v. Daniel,* 459 U.S. 551 at 558 (1979).

This theory is equally applicable to time certificates of deposit which, like pension plans, were commonly used and known to the legislators who framed the acts.[5]

The Third Circuit in this case looked to other sections of the definition, but was ambiguous as to whether it based its opinion on the "any note" phrase in the definition or whether it viewed the certificate as an "investment contract." Noting that the Marine Bank certificate had a due date in excess of nine months, the majority opinion concluded that the certificate of deposit is "the functional equivalent of any other corporation's bond or note." (Pet. for Cert. A.12). Yet the majority relied almost exclusively upon this Court's decision in *Tcherepnin v. Knight,* 389 U.S. 332 (1967), which dealt with the phrase "investment contract". (Pet. for Cert. A.11). The key to the Third Circuit's inexactness is found in its faulty premise that the definition of a security ought to be interpreted with "a presumption of coverage of any transaction which Congress did not expressly exclude." (Pet. for Cert. A.13). This premise conflicts with this Court's decision in *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551, which analyzed the particular financial relationship to determine whether Congress intended to *include* non-contributory compulsory pension plans, rather than to exclude them. This approach, when applied to a bank certificate of deposit, leads to the conclusion that the 1933 and 1934 securities statutes were not intended to encompass documents which evidence ordinary banking and deposit accounts.

In applying the *Tcherepnin* test for an investment contract as a scheme involving a common enterprise with profits to come solely from the efforts of others, the Third Circuit found the certificate of deposit to be "functionally" the same as the shares involved in *Tcherepnin v. Knight,* 389 U.S. 332 (1967). In so holding, the court ignored critical differences between the two instruments.

5. In contrast to the omission of time certificates of deposit from the definition of "security", the Glass-Steagall Act, passed by the same 73rd Congress, refers in several sections to time certificates of deposit. 12 U.S.C. § 371a; 12 U.S.C. § 264(c) (12); 12 U.S.C. § 264(v) (8).

The bank time certificate of deposit at issue in this case is payable in dollars at a fixed future date of February, 1984. (J.A. 30). In return for the certificate, the Weavers receive interest at a fixed and contracted rate. The Weavers are entitled to receive that sum on that date notwithstanding the "entrepeneurial or managerial efforts" of Marine Bank or its profitability.[6]

A certificate of deposit of this nature contrasts sharply with the withdrawable capital shares in a savings and loan association held in *Tcherepnin* to possess the essential characteristics of an investment contract as that term is used in the Securities Exchange Act of 1934.[7] The withdrawable capital shares in *Tcherepnin* were found to be investment in nature because the holders were automatic members of the association, entitled to vote and not entitled to a fixed rate of return. Rather, under Illinois law, the holders received dividends as declared by the association's board of directors and based on the association's profits. As a result of state law tying dividends to an apportionment of profits, the shareholders in *Tcherepnin* received a return on investment only if the association was profitable due to the skill and honesty of its management. This arrangement is in marked variance with the bank certificate of deposit, which pays a fixed rate of interest not related to the profits to be realized, if any, by the bank from the use of the money and uninfluenced by the managerial skills of the bank. Owners of a bank certificate of deposit are not entitled to vote, they do not own shares in the bank and are not entitled to a voice in the management of the bank. It is closer in nature to a savings account than to the capital stock of the bank.

The Third Circuit's misconstruction of *Tcherepnin* was based upon a false impression. The court reasoned that when this Court decided *Tcherepnin*, it "must have been aware" that the administrator of National Banks had in 1966 endorsed the Securities and Exchange

6. In fact, Marine Bank is prohibited from using the term "profit" in referring to interest paid on a time certificate of deposit. 12 C.F.R. Sec. 329.8(e).

7. The same definition of an investment contract applied in *Tcherepnin* as a common enterprise with profits to come solely from the efforts of a third party has been applied to the phrase "investment contract" in the 1933 Act. *SEC v. Howey*, 328 U.S. 293 (1945).

Commission's view that deposit accounts were securities. (Pet. for Cert. A.11). In fact, the various agencies controlling the banking industry had in 1966 *not* concurred in that position but merely stated it without concurrence in connection with certain advertising policies to be followed by financial institutions. 31 Fed. Reg. 16581-16582 (1966).

Three federal courts of appeals have considered the issue presented here and found that bank certificates of deposit do not constitute "investment contracts." In *Canadian Imperial Bank of Commerce Trust Company v. Fingland,* 615 F.2d 465 (7th Cir. 1980), it was held that a complaint alleging that trust funds were invested in certificates of deposit, issued by a Bahamian bank and bearing a fixed rate of return failed to allege a scheme involving a common enterprise with profits to come from the efforts of others. The Fifth Circuit has held that a certificate of deposit, issued by a commercial U.S. bank, is not an investment contract. *Bellah v. First National Bank of Hereford, Texas,* 495 F.2d 1109 (5th Cir. 1974). A certificate issued to a depositor by the Norfolk Savings and Loan Corp. was found by the Fourth Circuit to be commercial in nature and thus not a "security" under the 1934 Act. *Burrus, Cootes and Burrus v. MacKethan,* 537 F.2d 1262, *withdrawn as moot,* 545 F.2d 1388 (4th Cir. 1976), *cert. denied,* 434 U.S. 826 (1977). Finally, the Ninth Circuit examined an investment package in which a credit union purchased bank certificates of deposit from a broker who offered a 5/8% bonus on maturity. In holding that the financial relationship was a "security", the Court emphasized the nature of the transaction as an "integrated investment package which must be viewed in its entirety", thereby assuming the certificate of deposit alone did not constitute a "security". *Safeway Portland Employees' Federal Credit Union v. C.H. Wagner & Co., Inc.,* 501 F.2d 1120 (9th Cir. 1974).

A considerable number of district courts have also concluded that bank certificates of deposit are not securites as defined in the Securities Acts.[8]

Although discussing only the investment aspect of the Weavers' certificate of deposit, the majority opinion in the instant case also relies in part on the fact that the certificate of deposit does not mature until six years from the date of issuance and that the definition of a security excludes any note "which has a maturity at the time of issuance of not exceeding nine months." Securities Exchange Act of 1934, 15 U.S.C. § 78c(a) (10); Pet. for Cert. A.11. The negative pregnant that the Weaver certificate must be a security because it matured in more than nine months and is the "functional equivalent of any corporation's bond or note," is in error. (Pet. for Cert. A.12). A note payable in less than nine months may be a security, and notes which mature in more than nine months may not be securities. *Bellah v. First National Bank of Hereford, Texas, 495 F.2d at 1111-1112 (5th Cir. 1974); McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 at 492-494 (5th

8. In accord: *Ayala v. Jamaica Savings Bank,* CV-80-1802 (E.D. New York, June 15, 1981), CCH Federal Securities Law Reports par. 98041, holding that time certificates of deposit bearing a fixed rate of interest issued by an FDIC insured savings bank and providing no voting rights are not securities under the 1933 or 1934 Acts; *Hamblett v. Board of Savings and Loan Associations of the State of Mississippi,* 472 F. Supp. 158 (N.D. Miss. 1979), holding that "savings certificates" and "savings passbooks" issued by a stock savings and loan association as a result of depositing funds, bearing a fixed rate of interest and no right to vote, not a "security" under the 1934 Act; *Hendrickson v. Buchbinder,* 465 F. Supp. 1250 (S.D. Fla. 1979), holding that passbooks and certificates of deposit issued by a group of Bahamian banks not "securities" within the meaning of the 1934 Act; *State Public School Building Authority v. Mellon Bank, N.A.,* Civil Action No. 76-537 (M.D. Pa. July 3, 1980), holding that certificates of deposit issued by Mellon Bank in return for deposits of the State Public School Building Authority not securities within the meaning of the 1933 and 1934 Acts; *Swank Federal Credit Union v. C.H. Wagner & Co., Inc.,* 405 F. Supp. 385 (D.C. Mass. 1975), *assuming arguendo* that ordinary bank certificates of deposit are not securities.

In an analogous area, certificates of deposit issued by federally regulated banks have been held not to be securities under the Investment Company Act of 1940, 15 U.S.C. Sections 80a-1 *et. seq.,* which contains a definition of a security not significantly different from the Securities Acts. Investment Company Act of 1940, 15 U.S.C. Sec. 80a-2(a)(36); *SEC v. Fifth Avenue Coach Lines, Inc.,* 289 F. Supp. 3, 28, 31 (S.D.N.Y. 1968), *aff'd.* 435 F.2d 510 (2d Cir. 1970); *Drovers Bank of Chicago v. SFC Corp.,* 452 F. Supp. 580, 582 (N.D. Ill. 1978).

Cir. 1974); *Emisco Industries, Inc. v. Pro's, Inc.*, 543 F.2d 38 (7th Cir. 1976); *Lino v. City Investing Company*, 487 F.2d 689 at 693-696 (3rd Cir. 1973); *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976); *Zeller v. Bogue Electric Manufacturing Corp.*, 476 F.2d 795 (2nd Cir. 1973). The distinction drawn in these cases, and commonly referred to as the "commercial/investment" dichotomy, hold that notes executed in the context of a commercial—as opposed to investment—transaction are exempt from the Securities Acts.[9]

In *Bellah*, the debtors borrowed money from a bank to aid them in their livestock business, executing a note secured by a mortgage and pledge of a certificate of deposit. The debtors later claimed the bank misrepresented that they need not worry about foreclosure. The Fifth Circuit affirmed dismissal for lack of jurisdiction, stating:

> The record reveals that in extending the loans, the Bank merely intended to aid the [debtor] in the operation of their livestock business. It is bereft of any evidence that the Bank sought to profit from the successful operation of this enterprise . . . We merely hold that notes issued in the context of a commercial loan transaction fall beyond the purview of the [1934] Act. *Bellah v. First National Bank of Hereford, Texas*, 495 F.2d at 1113-1114 (5th Cir. 1974).

Concluding that the note itself was not a security because the transaction was commercial in nature, the court also held that the certificate of deposit likewise was not a security because it was part of the same commercial transaction. *Id.* at 1114-1116.

This commercial/investment distinction is critical to the difference between a certificate of deposit issued by a commercial bank and a debt obligation of a non-banking corporation. Marine Bank is in the business of borrowing and lending money. The interest to be paid the Weavers is fixed and does not depend on the profitability of Marine

9. M. Lipton and G. Katz " 'Notes' Are Not Always Securities", 30 Business Lawyer 763 (1975).

Bank.[10] Rather, Marine has promised to pay the Weavers a set amount of interest by contract. Regardless of the profits, if any, realized by Marine from the use of the Weavers' deposit, the bank is obligated to pay the stated interest. This transaction is a contractual obligation, not an investment.[11]

In addition to the language of the Securities Acts themselves, their legislative history is instructional on the issue of whether Congress intended a bank certificate of deposit to be security. This Court in *International Brotherhood of Teamsters v. Daniel* relied in part upon the legislative history of the Securities Act to conclude that Congress did not intend noncontributory, compulsory pension plans to be under the scope of the Securities Acts. *Daniel*, 439 U.S. at 563-564. Similarly, the legislative history of the 1933 and 1934 Acts infers that Congress did not intend bank certificates of deposit to be included as "securities." Just as ERISA, governing the use and terms of pension plans, undercut

10. While banks are frequently active in an aftermarket of certificate of deposit funds, this is the way in which banks make a profit for themselves, not their depositors. "If this were not the case, banks could not pay anyone interest on their deposits and everyone would be just as well off stuffing their money under their own mattresses...." *State Public School Building Authority v. Mellon Bank, N.A.*, Civil Action No. 76-537 (M.D. Pa. July 3, 1980) [holding that certificates of deposit issued by Mellon Bank in return for deposits of the Pennsylvania State School Building Authority were not securities within the meaning of the 1933 and 1934 Acts].

11. Besides "investment contract" or "note", the only other phrase which might literally apply to the present case is the phrase "evidence of indebtedness", which appears only in the 1933 Act. This Court has rejected a literal approach to the definitional section of the Securities Acts in favor of the economic realities of the transaction. *United Housing Foundation v. Forman*, 421 U.S. 837, 848 [rejecting the argument that "any...stock" included shares of stock issued by a non-profit housing cooperative]; *Tcherepnin v. Knight*, 389 U.S. 332, 336. The "economic reality" of the Weavers' purchase of the certificate was to have a deposit in a bank near their place of business—a commercial purpose. (J.A. 44; J.A. 62). The certificate was not transformed into a "security" when it was later pledged for the Piccirillo loan in an equally commercial context. Even under a literal reading, this phrase has been held not to include deposits in federally regulated banks. *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F.Supp 3, 28, 31 (S.D.N.Y. 1968); *Drovers Bank v. SFC Corp.*, 452 F.Supp. 580, 582 (N.D. Ill. 1978).

arguments for extending Securities Acts to certain pension plans,[12] so the Glass-Steagall Banking Act of 1933 and the Federal Deposit Insurance Act dealing expressly and in detail with bank certificates of deposits mitigates against extension of the Securities Acts to such documents.

Both the Securities Acts and Glass-Steagall were passed by the 73rd Congress to prevent the recurrence of abuses caused by bank involvement in securities activities which gave impetus to the 1929 stock market crash. The legislative purpose of federal regulation of securities transactions was stated in *Ernst & Ernst v. Hochfelder* as follows:

> The Securities Act of 1933 [cite omitted] was designed to protect investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and . . . to promote ethical standards of honesty and fair dealing [cite omitted]. The 1934 Act was intended principally to protect investors against manipulation of stock prices . . . and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges. [cite omitted].
> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 at 195 (1976).

The 1933 and 1934 Acts were, therefore, designed to protect investors in "securities" by assuring that those investors were adequately informed in buying and trading *without* guaranteeing the soundness of their investment.[13]

12. "If any further evidence were needed to demonstrate that pension plans . . . are not subject to the Securities Acts, the enactment of ERISA in 1974 would put the matter to rest . . . Congress believed that it was filling a regulatory void when it enacted ERISA, a belief which the SEC actively encouraged. Not only is the extension of the Securities Acts . . . unsupported by the language and history of those Acts, but in light of ERISA, it serves no general purpose." *Daniel*, 439 U.S. at 569-570.

13. "Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn a profit. There is, however, an obligation upon us to insist that every new issue of securities . . . shall be accompanied by full publicity and information . . ." House of Representatives Report No. 85, 73rd Congress, 1st Session, President Roosevelt's Message to Congress on March 29, 1933.

On the other hand, the Glass-Steagall Act, passed contemporaneously with the Securities Acts, was designed in part to *insure* deposits against loss through the creation of the Federal Deposit Insurance Corporation. Obviously distinguishing between investors covered by the Securities Acts and depositors covered by the Glass-Steagall Act, the 73rd Congress designed a system whereby depositors, unlike investors, would be afforded protection against risk of loss. Thus each depositor in an insured bank such as Marine is protected by federal deposit insurance on the aggregate of all deposits in that bank.

To further implement the distinction between investments and deposits, Section 16 of the Glass-Steagall Act prohibits national banks from underwriting securities and dealing in securities for a bank's own account. 12 U.S.C. § 24 (Seventh). The Federal Reserve Act subjects all state member banks to the same restrictions. 12 U.S.C. § 335. In addition, non-member state banks insured by the FDIC are indirectly also subject to this limitation. 12 U.S.C. § 378. This general prohibition against bank underwriting of securities was reinforced by § 21 of the Act, which makes it unlawful for any underwriter of securities to engage in the banking business.[14] This scheme was intended by Congress to sever commercial banking from investment activity for the reason that:

> ... Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities.
> *Investment Company Institute v. Camp*, 401 U.S. 617 at 629-630 (1971).

14. "(a) After the expiration of one year after June 16, 1933, it shall be unlawful—
(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor . . .". 12 U.S.C. § 378(a).

Marine Bank is clearly in the business of accepting deposits. If banks engaged in accepting deposits are prohibited under Glass-Steagall from issuing, selling and underwriting securities, and a certificate of deposit is a "security", the issuing of a certificate of deposit in return for a cash deposit must violate Glass-Steagall. The only way to refute this conclusion would be if a certificate of deposit could be a "security" for purposes of the Securities Acts but not for purposes of Glass-Steagall; that is, to say a "security" under Glass-Steagall is defined more restrictively than under the Securities Acts. Yet a narrow reading of the word "security" under Glass-Steagall was rejected in *Investment Company Institute v. Camp:*

> ... There is nothing in the phrasing of either § 15 or § 21 that suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.
> *Investment Company Institute v. Camp,* 401 U.S. at 635.

To treat a certificate of deposit as a security would superimpose on already existing federal and state banking regulatory schemes a second pattern of regulations by the Securities and Exchange Commission, with attendant risks of inter-agency conflict and of the SEC's want of specialized relevant expertise in this area of banking. *Burrus, Cootes and Burrus v. MacKethan,* 537 F.2d 1262 at 1265.

Insured banks are heavily regulated by rules prescribed by the Federal Deposit Insurance Corporation which provide a panoply of protections for time certificate of deposit owners such as the Weavers. The existence of this separate body of federal law dealing expressly and in detail with bank certificate of deposits undercuts arguments for extension of the Securities Acts to such documents, *International Brotherhood of Teamsters v. Daniel,* 439 U.S. at 569-570. Just as ERISA contains specific disclosure requirements to employees and further controls the substantive terms of pension plans, the Federal Deposit Insurance Act governs disclosures which must be made in connection with bank certificates of deposit and controls their substantive terms. For example, advertisements, announcements, and solicitations relating to interest or dividends paid on "deposits", which include time certificates of deposit, cannot be inaccurate, misleading,

or misrepresent the deposit contract. 12 C.F.R. § 329.1(b), (c); 12 C.F.R. § 329.8(f). The term "profit" may not be used in referring to interest of dividends paid on a time certificate of deposit. 12 C.F.R. § 329.8(e). Advertisements and solicitations relating to interest must be stated in terms of annual rates of simple interest. 12 C.F.R. § 329.8(a). If an advertised rate is payable only on deposits meeting time or amount requirements, the requirements must be clearly and conspicuously stated. 12 C.F.R. § 329.8(d). Interest rates and their computations are regulated, as are penalties on payments before maturity. 12 C.F.R. § 329.3; 12 C.F.R. § 329.6; 12 C.F.R. § 329.4. The FDIC examines its insured banks and may conduct special examinations for insurance purposes. 12 U.S.C. § 1817(a). The FDIC also has the power to order insured state nonmember banks to cease and desist unsafe or unsound banking practices on the violation of any rule or regulation of the agency. 12 U.S.C. § 1818(b) (1). Such practices can result in termination of insured status. 12 U.S.C. § 1818(a). Any bank officer or director engaged in such practices may be suspended or removed from office. 12 U.S.C. § 1818(e). These rules are enforced through a system of district offices, which include branches to handle and coordinate consumer complaints. This scheme of federal regulation provides protection to persons such as the Weavers both through insurance and through a system of controls regarding advertising, disclosures and terms of a certificate of deposit backed by a program of supervision, audits and disciplinary proceedings.

In addition to the FDIC regulations and examinations, Marine Bank is also thoroughly examined periodically by the Pennsylvania Department of Banking, which includes a review of all assets of the bank, all loans and collateral for loans, the conduct of its affairs, investments, the interests of insiders and compliance with the law. This examination is to "safeguard the interests of depositors, other creditors, or shareholders of the institution." Department of Banking Code, Act of May 15, 1933, 71 P.S. § 733-401. To add the regulations of the S.E.C. to these federal and state schemes would impose burdensome and duplicative regulations on an already highly regulated industry.

To affirm the Third Circuit's reasoning that the Securities Acts reach "virtually every transaction in which an investor might expect to receive a return on his money" (Pet. for Cert. A. 12-13), would extend

federal court jurisdiction to other banking transactions in which a bank issues an instrument which constitutes evidence of interest payable because of a currency deposit. In addition to a certificate of deposit, such transactions would include a money market certificate, a small saver certificate, a savings deposit and a negotiable order of withdrawal (NOW account). On the other hand, to exclude bank time certificates of deposit from federal securities law will not leave the Weavers and those similarly situated without redress. In addition to federal and state protective regulations and federal insurance, the Weavers may have a right of action under state law, as they have alleged violations of the Pennsylvania Securities Act of 1972, 70 P.S. § 1-101 *et seq.* (J.A. 8-9). This act, based on the Uniform Securities Act, contains a provision virtually identical to Securities and Exchange Commission Rule 10b-5. 70 P.S. § 1-401. The Weavers may be further protected from alleged bank fraud under Pennsylvania common law, as set forth in their complaint. (J.A. 9).

Rather than interpret the Securities Acts as a source of general federal jurisdiction to afford relief to the certificate of deposit owner who may pledge the certificate as collateral for a loan which goes into default, or who is unhappy with his or her deposit for whatever reason, Marine Bank would urge this Court to hold that an FDIC insured certificate of deposit, issued in exchange for currency by a commercial bank, and bearing a fixed rate of interest is not a "security" as defined in the Securities Act of 1933 and the Securities Exchange Act of 1934.

II. WHEN UNKNOWN TO THE LENDING BANK, AS CONSIDERATION FOR ACTING AS GUARANTORS ON A BUSINESS LOAN, AN AGREEMENT WAS SIGNED BETWEEN THE PRIMARY OBLIGORS AND THE GUARANTORS GIVING THE GUARANTORS:

(a) THE RIGHT TO USE THE BARN AND PASTURE OF THE BUSINESS;

(b) THE RIGHT TO RECEIVE 50% OF THE "ADJUSTED NET PROFITS" OF THE BUSINESS SO LONG AS THEY REMAINED CO-OBLIGORS;

(c) THE RIGHT TO RECEIVE $100 PER MONTH UNTIL REPAYMENT OF THE LOAN; AND

(d) THE RIGHT TO VETO ANY FUTURE LOANS TO THE BUSINESS, THE AGREEMENT IS NOT A

"SECURITY" AS DEFINED IN THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES AND EXCHANGE COMMISSION'S RULE 10b-5 AND, IF A SECURITY, THE BANK CANNOT BE HELD LIABLE.

Unknown to Marine Bank, and as consideration for acting as guarantors on the loan, an agreement was signed between the Piccirillos and the Weavers. This document gave the Weavers:

(a) the right to use the barn and pastures of Piccirillos' business;
(b) the right to receive 50% of the "adjusted net profits" of the business so long as Weavers remained co-obligors on the loan;
(c) the right to receive the sum of $100.00 per month until repayment of the loan; and
(d) the right to veto any future loans to Piccirillo's business. (J.A. 11-12).

The decision by the Third Circuit that this agreement (the "Piccirillo Agreement") constitutes a "security" seriously misapplies the criteria for a security under the 1933 Securities Act as set forth in *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946) and as extended to the 1934 Securities Exchange Act in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), which test requires "an investment of money in a common enterprise with profits to come solely from the efforts of others." (Pet. for Cert. A. 5-9). This phrase has been the subject of numerous and varying judicial interpretations. However, through the factual context of all these cases run common elements tht include multiple investors, pooled funds, public offerings or advertisements aimed at nonresident and frequently unwitting persons attracted solely by monetary profit and dependent on the management, expertise and control of a promoter. The emphasis placed on each individual factor depends upon the individual Circuit Court and its interpretation of the *Howey* test. Yet under none of the various tests developed by the Circuit Courts can the Piccirillo agreement be deemed to be a security.

Howey involved an offering to some 6,000 tourists and vacationers in the U.S. and Canada of a land sales contract for individual, small citrus groves. Being offered to nonresidents with no experienc e in the citrus business, the buyers were also offered a service contract wherein

the selling company then leased the land and cultivated and marketed the crops as one big citrus grove with a large force of skilled personnel and sophisticated equipment. The buyer had no right to market his crop, all the produce was pooled by the company and profits allocated at the time of picking. Such a scheme was found to be an investment in a common enterprise with profits to come solely from the efforts of the company.

Focusing upon the large number of investors, the common cultivation of all the groves, and pooling of produce, the Seventh Circuit has interpreted the *Howey* test to require both multiple investors and a pooling of funds. *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972). In *Milnarik*, the court found that an investment contract in which the plaintiffs had deposited money with a broker on the understanding that he could use the funds at his discretion to trade commodity futures for the benefit of the plaintiffs was not a "security" because (1) each investor had a separate unitary contract with the broker and (2) each contract was independent of the other since the funds in each were not pooled and the success or failure of one contract was not tied to the fortunes of the other contracts. The requirement of a sharing or pooling of funds was reiterated in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977), which rejected the contention that discretionary futures trading accounts were "securities" because the funds in the accounts were not commingled.

The same result regarding discretionary accounts was affirmed by the Third Circuit because the enterprise involved (1) no group of investors and (2) no pooling of funds for a common purpose. *Wasnowic v. Chicago Board of Trade*, 352 F. Supp. 1066, 1069 (M.D. Pa. 1972), *affirmed without opinion*, 491 F.2d 752 (3rd Cir. 1974), *certiorari denied*, 416 U.S. 994.

This pooling of assets among multiple investors, characterized as *horizontal* commonality, has been rejected by the Fifth Circuit and the Ninth Circuit which are aligned in their interpretation of the *Howey* test for a common enterprise as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties." *SEC v. Continental Commodities Corporation*, 497 F.2d 516 at 518 (5th Cir. 1974) quoting *SEC v. Glen W. Turner Enterprises, Inc.*, 474 F.2d 476 at

482 n. 7 (9th Cir.) *certiorari denied,* 414 U.S. 821 (1973). Noting that in *Howey* the inexperienced investors, knowing nothing about the citrus business, depended for their profits on the farming, managerial and marketing skills of the defendant company, the courts applying this test focus on the relationship between the investor and the promoter. Characterized as *vertical* commonality, this test requires that the fortuity of the investment be dependent on the promoter's expertise.

For example, in determining that a seller of commodities futures options who rendered investment counseling as part of an enterprise, the success of which was contingent upon that counseling, sold a "security", the Fifth Circuit focused upon the fact that the success of the investments, both individually and collectively, was dependent upon the promoter's capabilities. *Securities and Exchange Commission v. Continental Commodities Corporation,* 497 F.2d 516 (5th Cir. 1974). Similarly, the Ninth Circuit found an investment scheme when faced with a pyramid franchise which depended for its success on the efforts of promoters who gave the sales pitch and ran the motivational "Dare to be Great" seminars. *SEC v. Glen W. Turner Enterprises,* 474 F.2d 476 (9th Cir.), *cert. denied,* 414 U.S. 82 (1973).

Applying either of the approaches outlined above, the Piccirillo agreement fails to rise to the dignity of a "security." The requirement of multiple investors is lacking, the agreement being only between Raymond and Barbara Piccirillo and Samuel and Alice Weaver. (J.A. 11-12). As noted by Judge Weis in his dissent to this case, property owned by a husband and wife creates, in Pennsylvania, a tenancy by the entireties which means the interest of a husband and wife is considered one estate and each spouse is seized of the whole. Pet. for Cert. A.17, n.1, citing *In re Holmes Estate,* 414 Pa. 403, 406, 200 A.2d 745 (1964); *Nachman v. Nachman,* 417 Pa. 589, 208 A.2d 247 (1965) [registration and placement of securities in names of husband and wife created tenancy by entireties in the securities]. Thus there exists only one "investor"—Mr. and Mrs. Weaver. The requirement of a pooling of assets is lacking, the Weavers having pooled funds with no one. Thirdly, the success of the business arrangement is not totally dependent upon the skills of the Piccirillos, nor is Mr. Weaver a non-resident inexperienced in the cattle business. Not only are the Weavers given absolute veto power over future loans to the business, they are also given a right to use the business barn and pasture, a tangible benefit to

the Weavers who operated a cattle livestock auction in the same locale. (J.A. 11-12, par. 2A, 3). Unlike the investors in *Howey*, who "resided" in distant localities and were totally unfamiliar with the citrus business, the Weavers are cattle dealers in the same small Pennsylvnaia town who sat down face-to-face in a trailer with the Piccirillos' and hammered out an agreement tailor-made to their individual needs.[15] Such an agreement was and is wholly unsuited to accommodate outside third persons, and no public interest is affected by its existence. It stands in sharp contrast with the public offerings and promotions involved in the two seminal cases decided by this Court. *[SEC v. Howey, supra,* involving sales to 42 nonresidents and offers to 6,000 tourists and vacationists; *Tcherepnin v. Knight, supra,* a class action by more than 5,000 investors]. Finally, even if the fortunes of the Weavers may have depended to some degree upon the efforts of Piccirillo, the same is not true for the bank. The bank simply made a collateralized loan and no allegation has been made that the bank was involved in the enterprise.[16]

The fact that the Piccirillo agreement was a tailor-made arrangement between two men engaged in the cattle business, with personal use accommodations made for the Weavers, added to Weavers' control over future loans to the business, the lack of any public interest in the transaction, and the absence of multiple investors, a pooling of assets, a public offering or advertising, all combine to remove the Piccirillo agreement from the boundaries established by this Court for an investment "security."

These same elements combine to remove the Piccirillo agreement from the parameters of a profit-sharing agreement. A profit-sharing agreement requires generally the same elements of mutual risks, public

15. In fact, on the day the agreement was signed, the parties negotiated a change in Weavers' share from 35% to 50%. (J.A. 11; Depo. A. Weaver, Tr. 51; Depo. E.M. Weaver, Tr. 27).

16. The bank had no knowledge the Piccirillo-Weaver agreement existed, as discussed *infra.* Marine expected nothing more than repayment of its loan. This is unlike the enterprise in *Hector v. Wiens,* 533 F.2d 429 (9th Cir. 1976), where the defendant farmer alleged that a feedlot, which fed and old his cattle, had promised the bank that it would seek potential cattle buyers and refer them to the bank for recommendations and financing.

participation, pooling and dependency on promoter expertise. The courts have applied the same econmic tests to profit-sharing agreements as to investment contracts. *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 at 102 (7th Cir. 1979) and cases cited therein. Nor should any literal distinctions be made, the courts being guided by the economic realities of the situation; not by the labels employed the parties. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851-852; *accord, International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 at 558.

Since the Marine Bank neither purchased nor sold the Piccirillo agreement, it can be liable only if it knew its misstatements would be used in connection with the purchase or sale of the Piccirillo agreement. The court of appeals erred in not requiring any allegation of scienter or knowledge on the part of the bank that its alleged misrepresentations might be or would be used in connection with the agreement.

The bank officers involved could not have known that their alleged misstatements would be used "in connection with" the Piccirillo agreement for the simple reason that the bank did not know the agreement existed.[17] The agreement was, in fact, a secret "side" agreement proposed by Mr. Piccirillo to induce Mr. Weaver to act as a guarantor on his loan. Piccirillo offered Weaver "a little share of the business." (J.A. 62; Depo. E.M. Weaver, Tr. 24-25). The agreement, prepared by Piccirillos' attorney, was taken to the Weaver

17. Judge Gibbons of the Third Circuit at oral argument indicated that whether the bank knew of the agreement was a question of fact for a jury. This cannot be a question of fact when the plaintiffs (1) have not pleaded that the bank knew or should have known of the agreement, (J.A. 4-10); (2) did not deny in their counter-affidavits the sworn statments of the bank officers submitted in conjunction with the summary judgment motion that they had no knowledge of the contract or its contents (J.A. 20-38) and (3) admitted in depositions that they never told the bank about the agreement. (J.A. 62-63; J.A. 64). Since the bank presented through deposition and affidavit evidence that would entitle it to a directed verdict if not controverted at trial, this evidence must be accepted as true on the summary judgment motion. The undisputed statements contained in the bank's affidavits are taken as true. The Weavers' failure to offer counter-affidavits or other evidence to indicate that the bank had knowledge of the agreement resolves the factual determination in favor of the bank. Federal Rule of Civil Procedure 56(e). Jurisdictional issues are for the court, not a jury, to decide, whether they hinge on legal or factual determinations. *Williamson v. Tucker*, 632 F.2d 579 at 588 (5th Cir. 1980).

home where the four of them, after making certain changes, signed it. (J.A. 62; Depo. E.M. Weaver, Tr. 25-29, 31). Although the Weavers kept a signed copy, Mr. Weaver responded to the question "Did you ever tell the Marine Bank about that agreement?" as follows:

> No; they never knew about that agreement, that I know of. I never told them. In fact, I never was to the bank from the time I loaned the money, put the money in the C.D.... (J.A. 62-63).

Identical testimony was offered by Alice Weaver who testified:

Q. - Did you tell Mr. Santom about the agreement with Mr. Piccirillo?
A. Weaver: No.
Q. - Is there any reason why you didn't tell him about it?
A. Weaver: No.
Q. - You had the original of this in your possession, isn't that correct?
A. Weaver: That's right.
Q. - But you didn't bring it with you to show it to the Marine Bank at all?
A. Weaver: No. (J.A. 64).

Futhermore, Robert Santom and John Daggett, the only employees of Marine Bank who had any dealings with the Weavers, both submitted affidavits that they had never seen the contract and had no knowledge of its contents or of *any* interest of the Weavers in the business, oral or written, in addition to their commercial obligations as guarantors of the loan. (J.A. 20-38). These affidavits wer uncontradicted by the Weavers. (J.A. 41-43). The mere failure of the bank to discover the existence of the agreement in the course of a routine commercial transaction cannot be a basis of 10b-5 liability, just as the failure of an accounting firm to discover internal fraudulent practices of a client in the course of a routine, procedurally proper audit cannot sustain an action under 10b-5. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

18. As further inducement to act as co-guarantor, Mr. Piccirillo gave Weaver a $10,000 note against Piccirillo's father's home. "Yes, give me elder Piccirillo's note for ten thousand dollars, that I wouldn't lose any money through loaning him a little capital through the bank." (Depo. E. M. Weaver, Tr. 25).

Since the bank did not know of the agreement, the bank's liability arises only because it failed to discover Mr. Piccirillo's activities in offering the "little share of the business" to Weavers—that is, the bank's liability is secondary liability. In *Ernst & Ernst v. Hochfelder*, this Court upheld a motion for summary judgment where the plaintiffs, victims of a fraudulent securities scheme by a brokerage firm president, failed to allege an intent to deceive on the part of the accounting firm auditing the firm's books, but rather sought to recover on the basis of the accountant's failure to discover the fraud. Rejecting a negligence standard, this Court found an allegation of scienter necessary to state a private cause of action for damages under Rule 10b-5. Scienter was also held to be an element of a civil enforcement action by the Commission. *Aaron v. SEC*, 446 U.S. 680 (1980). The Third Circuit's holding in this case that 10b-5 liability can be predicated upon the bank's negligence in failing to discover the Piccirillo agreement ignores that scienter requirement. It transforms a bank into an insurer of the integrity of its customers, and would impose 10(b) liability on any institution lending money to the market manipulator. The plight of Marine Bank in this situation has been illustrated as follows:

> If all that is required in order to impose liability for aiding and abetting is that illegal activity under the securities laws exists and that a secondary defendant such as a bank, gave aid to that illegal activity, the act of loaning funds to the market manipulator would expose the bank to liability for aiding and abetting. Imposition of such liability upon banks would virtually make them insurers regarding the conduct of insiders to whom they loan money. If it is assumed that an illegal scheme existed and that the bank's loan or other activity provided assistance to that scheme, some remaining distinguishing factor must be found in order to prevent such automatic liability. *The bank's knowledge of the illegal scheme at the time it loaned the money or agreed to loan the money provides that additional factor.* Knowledge of wrongful purpose thus becomes a crucial element . . . Ruder, *Multiple Defendants in Securities Law Fraud Cases*, 120 U. Pa. L. Rev. 597 at 630-631 (1972). (Emphasis added).[19]

19. This concept has also been applied in the criminal law context. This Court has held that to aid and abet a crime, it is necessary that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed." *Nye & Nisson v. United States*, 336 U.S. 613, 619 (1949).

The Fifth Circuit has followed the scienter requirement in a case almost identical to the instant one, holding that in order for a bank to be exposed to 10b-5 liability, a violation of the securities laws must exist, the bank must be generally *aware* of its role in the improper activity, and *knowingly* render substantial assistance.[20] *Woodward v. Metro Bank of Dallas*, 522 F.2d 84 (5th Cir. 1975). In *Woodward*, the plaintiff co-signed a bank note on behalf of a corporation and pledged a certificate of deposit, along with corporate stock as collateral. The corporation subsequently filed bankruptcy proceedings and the plaintiff sued the bank, among others, alleging failure to disclose all its information about the corporation's financial status. Assuming *a fortiori* that the note and pledge of stock was a "security", the court held that in a commercial transaction, the bank must be aware of the improper activity and knowingly assist it. The same standard that the defendant must know of the securities violation and knowingly render substantial assistance has also been adopted in the Second, Sixth and Third Circuits. *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978); *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974); *Landy v. Federal Deposit Insurance Corporation*, 486 F.2d 139 (3rd Cir. 1973).

In this case the alleged violator, Marine Bank, was engaged in a customary business activity—that of loaning money. How can the bank protect itself from 10b-5 liability in such a setting? To discover the Piccirillo agreement, the bank would have had to investigate the activities of Mr. Piccirillo and fully inquire into the motives of Mr. Weaver for acting as a guarantor.[21] The bank would have had to

20. This test is the same as that contained in the Restatement of Torts, Sec. 876(b).

21. Parenthetically, inquiry by the bank as to why Weaver was acting as a guarantor did not serve to reveal the Piccirillo agreement. The bank was told the reason for Weavers' interest was the obvious benefit to a cattle auctioneeer in assisting a local meat dealer who had daily contact with cattle farmers.

Daggett: "The only thing that Tony [Piccirillo] ever said, that he would possibly be able to help Sam [Weaver] in his business, that Tony knew a lot of farmers that may be able to help Sam's business, because Tony knows a lot of people who Sam didn't. And Sam's age, Tony would be a much younger man and stuff, that he might be able to help him that way." (J.A. 59).

Santom: "I can recall one particular conversation that I had with Tony [Piccirillo] about this and he implied that his connections with the farmers around the area and so forth was going to assist in increasing the sale of cattle through Sam's [Weaver] auction barn, but that was the extent of any conversation . . .". (J.A. 49).

determine incontrovertibly that the Weavers and Piccirillos has made no "agreement" which might be construed as a "security" and, in addition, ascertain through some undefined method that Piccirillo had perpetrated no fraud on Weaver. Since it would be impossible for any bank employee to assume the non-existence of fraud, a bank would in the alternative have to assume that fraud existed in all accommodation arrangements and automatically interject itself into those arrangements on pain of 10b-5 liability by releasing to the potential co-obligor the entire financial history and credit status of the primary debtor.[22]

This is not to infer that a bank's duty to disclose such information may not arise in some circumstances and under some body of applicable law. The relationship between a bank and its customers is governed by many laws, including others the Uniform Commercial Code, Truth-in-Lending, the Equal Credit Opportunity Act, state banking statutes and common law, any one of which might govern the fact situation presented here.

However, nothing in the statutory language, legislative history of judicial interpretations of the Securities Exchange Act infers that Rule 10b-5 was meant to be extended this far. To expose banks to automatic 10b-5 liability for the acts of its debtors in the course of routine commercial transactions will impose an entire federal scheme on an already highly regulated industry while affording no additional protection to those persons which 10b-5 was designed to protect.

22. This may be confidential information that the customer does not want made public. It will in almost all situations involve a customer not credit-worthy on his or her own, as "the *raison d'etre* of accommodation is to find stronger financial support. . .". *Woodward*, 522 F.2d at 99. The customer may well complain that the bank is interfering with his or her contractual relations.

CONCLUSION

For the foregoing reasons, the order of the district court granting the motion for summary judgment should be affirmed and the action dismissed.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK,

Petitioner,

v.

SAMUEL WEAVER AND ALICE WEAVER,

Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Third Circuit

BRIEF FOR RESPONDENTS

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STATEMENT OF ISSUES PRESENTED

1. Whether there was a genuine issue of material fact with respect to either the Columbus profit sharing agreement or Weavers' six year certificate of deposit being a security, or involved in a "securities transaction" protected by Rule 10 b-5 of the Security and Exchange Commission or Section 17(a) of the Securities Act of 1933 to preclude summary judgment.

2. Whether this Court, even if it should find no purchase and sale of a security or a "securities transaction" within either the 1933 or 1934 Acts, should remand this case to the District Court so that the District Court can resolve the pendent state claims in accordance with the Order of the Third Circuit Court of Appeals.

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IN THE

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MARINE BANK,

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v.

SAMUEL WEAVER AND ALICE WEAVER,

Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Third Circuit

BRIEF FOR RESPONDENTS

COUNTER STATEMENT OF CASE

Sam and Alice Weaver (hereinafter "Weavers") filed a three count complaint against Marine Bank (hereinafter "Bank") in the United States District Court for the Western District of Pennsylvania. The substance of all Counts related to material misrepresentations made by Marine which induced Weaver to pledge a $50,000.00 Certificate of Deposit to Marine on or about March 17, 1978, in exchange for Weavers receiving the right to share in the profits of a slaughterhouse business known as Columbus Packing Company (hereinafter "Columbus").

Count One claimed that the transaction imposed liability against the Bank under the Securities Exchange Act of 1934 (hereinafter the "1934 Act"), 15 U.S.C. § 78(j)(b), and the Securities and Exchange Commis-

sion's Rule 10 b-5 (hereinafter "Rule 10 b-5"), 17 C.F.R. 240, 10(b)-5 (JA-4).[1] Count Two claimed that the same transaction imposed liability against the Bank for violations of the Pennsylvania Securities Act of 1972, 70 Pa. Stat. Ann. § 31 (1972) (JA-8). Count Three claimed that the Bank was liable to the Weavers for common law fraud and misrepresentation under Pennsylvania law (JA-9).[2]

The District Court granted the Bank's motion for summary judgment and dismissed the Weavers' action holding that there was no purchase or sale of a security within the context of either Rule 10 b-5 or Section 17(a). Without diversity of citizenship, the Court also held that it lacked jurisdiction to hear the merits of the claim.[3] The

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[1] (JA) refers to Joint Appendix filed with this Court.

[2] Within a couple weeks of a scheduled trial, and after extensive discovery by both parties and after Pre-Trial Narrative Statements were filed by both parties, the Bank moved for Summary Judgment under Rule 56 of the Federal Rules of Civil Procedure claiming, in substance, that there was no purchase or sale of a security so as to impose liability under Rule 10 b-5 in favor of the Weavers against the Bank (JA-19). The Weavers filed a written answer (JA-39) to the Bank's motion for summary judgment attaching an affidavit of the Weavers (JA 41-43). The Weavers claimed that genuine issues of material fact as to whether there was a purchase and sale of a security imposing liability in favor of the Weavers against the Bank, not only under Rule 10 b-5 made reference to above, but also under Section 17(a) of the 1933 Securities Act, 15 U.S.C.A. § 77(q), precluded the Court from granting the Bank summary judgment under Rule 56 of F.R.C.P. (JA-39).

[3] To clarify the record, the Weavers moved to amend the original complaint after the Court rendered its Opinion granting the Bank's motion for summary judgment, so that it was clear on the record that Weaver was claiming liability under Rule 10 b-5 and Section 17(a). The Court denied the Weavers' motion to amend the complaint as being "unnecessary" as under Rule 15(a) and (c) of the F.R.C.P.

Court incorporated by reference the legal authorities and position of the Bank set forth in its brief (PA-28).[4]

The District Court also dismissed the state law claims against the Bank under Counts Two and Three. The District Court held that there was no independent jurisdictional basis for these claims and that it did not have pendent jurisdiction over these state law claims once the federal claims were dismissed (PA-27, 28).[5]

In reversing the District Court, the Third Circuit Court of Appeals held that there was genuine issues of material fact as to whether there was a purchase and sale of a security, *either* by the pledge of the Certificate of Deposit or the sale of the agreement from Columbus to share up to 50% of the profits of Columbus, which precluded the District Court from granting summary judgment in the claims premised upon the Federal Securities Act (PA-9, 12). The Third Circuit also held that it was error for the District Court to dismiss the state law claims in Counts Two and Three of the complaint in that the District Court had pendent jurisdiction over these claims as they arose

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All theories of liability advanced by the Weavers, including those theories not set forth in the original complaint but identified in responses to the Bank';s motion for summary judgment were considered and rejected by the Court.

[4] (PA) refers to the Petitioners' Appendix included in the Petition for Certiorari filed with this Court.

[5] Because the thrust of the Bank's motion was directed to the claims under the Federal Securities Acts, the parties never briefed the pendent jurisdiction issue to the District Court. There was no indication on the record that the District Court exercised any type of discretion in deciding whether or not it had pendent jurisdiction over the state law claims or that it considered the issues of similarity between the federal and state law causes of action, judicial economy, etc. in determining whether or not it should exercise pendent jurisdiction over the state law claims.

out of the same operative facts as the claims premised under the Federal Securities Act (PA-12-14); it held, as a matter of judicial economy, that all claims relating to these transactions should be resolved in one proceeding in the federal forum (PA-13).

Columbus was a slaughterhouse and retail meat store operated as a sole proprietorship by Raymond and Barbara Piccirillo and located in Columbus, Pennsylvania, a town closely proximate to the Bank's Corry branch office and to the Weavers' home in Union City. The Bank, between 1976 and 1978, made three separate demand loans to Columbus totaling $33,000.00. The Bank intended to collateralize these loans to Columbus by filing U.C.C. claims against the equipment and other assets of Columbus but because it failed to properly perfect its security interest against Columbus' assets,[6] it did not have a secured position with Columbus as of March 17, 1978.

All three of these loans were overdue on January 16, 1978 and Columbus was not able to make any interest or principal payments on that date or thereafter (CA-247).[7] Additionally, at all material times throughout 1977 and through March 17, 1978, Columbus' checking account at the Bank was continuously in an overdraft position (CA-229, 230, 402). The Bank had been fully aware that Columbus was insolvent and without an adequate capital base from its inception in 1976 (CA-209). The Bank's officers attempted repeatedly to cure the "continuing prob-

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[6] The Uniform Commercial Code, 13 Pa.C.S.A. § 9401 (1980), requires the filings to be made in the county where the equipment is located. The Bank filed in Erie County but not in Warren County, the situs of the equipment.

[7] (CA) refers to Appellant's Appendix filed in the Court of Appeals.

lem" with the overdrawn checking account, without success (CA-424, 425).[8]

Being unable to collect its interest and principal on these three loans and unable to solve the Columbus overdraft problem through normal commercial banking procedures, the Bank became actively involved in persuading Piccirillo to secure an investor for Columbus. Working capital was also sought by way of a loan from the United States Small Business Administration ("S.B.A."). The bank hoped that the loan would correct

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[8] On December 28, 1977, the auditor in charge of fraud control of Marine issued a memo to all Marine officers alerting those officers of the "continuing problem" with the Columbus Packing Company checking account (CA-413). It was reported then that:

"1. Subject: checking account, held at the Corry Office, has appeared on the overdraft report an excessive number of times in the past several months. Details of the account are as follows:

a. Name and Address of Account: Columbus Packing Company, R.D. # Lottsville Road, Columbus, PA

b. Account Number: 1001-3029

c. Account Opened: May 7, 1976

d. Checks Returned: 17 (lifetime of account)

e. Number of times overdrawn: 189 (lifetime of account)

f. Current Balance: $9,345.02 Overdrawn

g. Currently Overdrawn Since: September 20, 1977

This account has been in an overdraft status almost constantly since April, 1977, with an average overdrawn balance of approximately $9,000.

2. I have discussed the account on numerous occasions in the past with Corry management and was advised that an SBA loan was being processed which would resolve the overdraft problem. I further discussed the account with R. Santom, this date, for the first time since he assumed the position of Manager, Corry Area, and was informed that he had discussed the account with R. Ross and T. Doolin and that ways and means to resolve the problem are currently being studied . . ."

the Columbus "overdraft" (See Footnote 8). The S.B.A. denied Columbus' application in September of 1977. Subsequent to the denial, the Bank further advanced $20,000.00 to Columbus, the third of the three loans totaling $33,000.00 (CA-431).

In March, 1978, Sam and Alice Weaver were retired farmers; they had no formal education beyond the eighth grade; they were age 78 and 71, respectively; and since 1976, they conducted a small livestock auction (JA-41). Although they were aware of Columbus because they were in related businesses, they had no interest in making any type of investment in Columbus prior to the Bank's solicitations in February and March, 1978 (CA-306, 310, 311). The Weavers had also previously refused solicitations by Columbus (CA-303).

The Weavers withdrew $50,000.00 from a North East, Pennsylvania bank and on February 28, 1978, purchased a $50,000.00 certificate of deposit ("CD") at the Bank's Corry branch (CA-312).[9] This CD had a maturity date of six years and paid 7-1/2% interest. The Weavers intended to use this CD as a source for working capital in their livestock auction business (JA-41). The Weavers had already been solicited by the Bank to make an investment in Columbus prior to the purchase of the CD on February 28, 1978 (CA-130, 134).

The Bank considered the Weavers as "investors" in Columbus (JA-53), even though their investment would be made through the Bank by way of the pledge of their CD (JA-57). The Bank represented to the Weavers that with the "proper money being invested," the Bank

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[9] The CD purchased by Weavers on February 28, 1978 from the Bank is reproduced and attached to the back of the Brief filed by the American Bankers Association at page 1a.

would "restructure" its loan to Columbus (CA-147). Bank officers handling this transaction considered the amount of Weavers' potential "investment" in Columbus as "$50,000.00" (JA-56).

After frequent personal visits to the Weavers' farm (CA-308), on March 15, 1978, a Bank officer persuaded the Weavers to pledge their $50,000.00 CD in exchange for the Bank's $65,000.00 loan to Columbus on the representation to Weavers that, among other things, Columbus would receive all or substantially all of the $65,000.00 as "working capital" (CA-311; JA-41).[10] At no time prior to March 17, 1978 were the Weavers aware that Columbus was indebted to the Bank or that Columbus had any serious financial problems (CA-309, 312, 325).

On March 17, 1978, the Weavers pledged their CD to the Bank which, in turn, loaned Columbus $65,000.00. Just prior to March 17, 1978, and in consideration for the Weavers' pledge of their CD to the Bank, the Weavers executed a written agreement with Columbus which granted them "50% of the adjusted net profits" of Columbus (CA-319).

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[10] On, and prior to, March 17, 1978, the Bank represented to the Weavers the following: (1) all of the $65,000.00 would be available to Columbus for working capital; (2) there was little risk to the Weavers in making this pledge; (3) the Bank had perfected security interests in Columbus' equipment and accounts receivable; (4) the value of this collateral was substantial enough to protect the Bank *and* the Weavers (CA-310); and (5) the Bank would provide the Weavers with a monthly profit and loss statement of Columbus so that the Weavers could monitor the activities of Columbus (JA-41, 42).

These representations proved untrue and one or all of the representations induced the Weavers to pledge their CD to the Bank in exchange for the right to receive up to 50% of the profits of Columbus (JA-42, 43).

The Bank on March 17, 1978, prior to Columbus receiving any of the $65,000.00 in loan proceeds, paid itself $42,515.37 to cover the $34,756.61 loan plus $7,758.77 overdraft position existing in the Columbus checking account. A substantial portion of the remaining $65,000.00 was distributed by the Bank to trade creditors of Columbus who had given notice of their claims prior to March 17, 1978. Approximately $10,133.06 was made available prior to the satisfaction of the $6,300.00 I.R.S. lien (CA-338, 429) for 1977 payroll tax which Columbus had not paid as of March 17, 1978 (CA-276). This left $3,833.06 available to Columbus for working capital. The Bank was fully aware as of March 17, 1978, that this was an inadequate amount of working capital to keep Columbus in business, as the Bank believed that it would take at least $10,000.00 in working capital to "keep this business going" (CA-217). The Weavers were not aware of this disbursement schedule but if they had been, they would not have pledged their CD (CA-327). The Bank, at the same time, closed the existing Columbus checking account and opened a new account. Thereafter, the Bank refused to honor any more Columbus overdrafts and the Columbus checks were being returned because of insufficient funds (CA-338).

After March 17, 1978, the Weavers began receiving checks of Columbus that were returned for insufficient funds. This was the first that the Weavers were aware of Columbus' financial problems and that the Bank had used all or substantially all of the $65,000.00 to reimburse itself for the past indebtedness of Columbus (CA-338).

The primary beneficiary of the proceeds from the $65,000.00 loan was the Bank in that it: (a) provided a vehicle for the Bank to collateralize its indebtedness with Columbus when it had not been properly collateralized

prior to March 17, 1978; and (b) allowed the Bank to correct the "continuing problem" with the Columbus overdraft. At the time that Marine made the $65,000.00 loan to Columbus, there was no reasonable expectation that Columbus would ever be able to repay the principal and interest on the $65,000.00 loan considering that: (1) Columbus was not able to make the principal and interest payment on the $33,000.00 loans previously made by the Bank; (2) Columbus was insolvent at all material times prior to, and after, March 17, 1978; and (3) Columbus was receiving an inadequate amount of working capital to keep its operation going.

On May 9, 1978, as a consequence of insufficient working capital, Columbus elected to close its business (CA-255). In July of 1978, Columbus filed for bankruptcy in the United States District Court for the Western District of Pennsylvania.

The Bank has refused to return the Weavers' $50,000.00 Certificate of Deposit. Marine has not yet foreclosed on the CD, but concedes that foreclosure is inevitable.[1]

SUMMARY OF ARGUMENT

When reviewing a motion for summary judgment made under Rule 56(c) of the F.R.C.P., a court is obligated to review the entire record and construe the facts in the depositions, exhibits, and supporting affidavits and draw the logical inferences from these facts, most favorable to the non-moving party, in this case, the Weavers. *U.S. ex rel Jones* v. *Rundle,* 453 F.2d 147 (3rd Cir. 1971); *Adickes* v. *Kress & Company,* 398 U.S. 144 (1970).

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[1] See Paragraph 11 of Weavers' Complaint (JA-8) and Marine's Answer (JA-16) admitting Weaver's allegations in the Complaint.

In granting summary judgment, the District Court held that neither the Columbus profit sharing agreement sold to Weaver in early March of 1978 nor a six year bank Certificate of Deposit pledged by Weaver to the Bank on March 17, 1978 were securities protected by the anti-fraud provisions of either of the Federal Securities Acts. The Third Circuit correctly concluded that there were facts which would support a conclusion that the Columbus agreement was either: (1) an "investment contract" within *S.E.C.* v. *Howey,* 328 U.S. 293 (1946); or (2) a "profit sharing agreement" within *S.E.C.* v. *Addison,* 194 F.Supp. 709 (N.D. Tex. 1961); or (3) a "certificate of interest." *See Crowell* v. *Pittsburgh & Lake Erie Railroad Company,* 373 F.Supp. 1303 (E.D. Pa. 1974).

To induce the Weavers to pledge their CD to the Bank, the Bank represented to Weaver, among other things, (see Footnote 10) that the pledge would generate $65,000.00 of working capital for Columbus by way of a loan, and that the Bank had adequate collateral from Columbus as of March 17, 1978 to protect Weavers' pledge. Neither was true. Substantially all of the $65,000.00 generated by this pledge was used by the Bank to pay delinquent loans and an overdraft which Columbus owed the Bank. Whether Marine made these representations with the requisite "scienter," *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), or whether they were made "in connection with" these transactions were issues not resolved by either the District Court or the Third Circuit Court of Appeals and, therefore, are not before the Court at the present time.

The three requirements of the *Howey* test for an investment contract are established by the facts in this case: (1) The Weavers' pledge of their CD to the Bank could be found to be an investment of money in Columbus, *Hector* v. *Wiens,* 533 F.2d 429 (9th Cir. 1976); (2) Col-

umbus was a "common enterprise" and all vertical and horizontal commonality requirements were satisfied, *Hector* v. *Wiens, supra.*, at 33; *Rochkind* v. *Reynolds Securities, Inc.*, 388 F.Supp. 254 (D. Md. 1975); and (3) the Weavers had an "expectation of profits from the efforts of others" in that the profits to be generated by Columbus were primarily dependent upon Piccirillo, *S.E.C.* v. *Glenn Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973), cert. denied 414 U.S. 82 (1973).

The Bank's knowledge of the Columbus agreement with the Weavers and the Weavers' expectations of profits from Columbus could be inferred from the circumstantial evidence, *Ferguson* v. *Omnimedia, Inc.*, 469 F.2d 194 (1st Cir. 1972). Primary liability could therefore be imposed with respect to the Columbus agreement; secondary liability could be imposed. *Monsen* v. *Consolidated Dressed Beef Company, Inc.*, 579 F.2d 793 (3rd Cir. 1978).

The Third Circuit also correctly concluded that the CD, pledged by the Weavers to the Bank, as consideration for future profits in Columbus and as collateral for a $65,000.00 loan, was a security traded in a securities transaction within the protective scope of the Federal Securities Acts, *United States Housing Foundation* v. *Forman*, 421 U.S. 850, 859, 860 (1975). This six year CD was literally a "note" within the definition of security within the 1933 and 1934 Acts and "evidence of indebtedness" within the definition of the 1933 Act. *Garner* v. *Pearson*, 374 F.Supp. 591 (D. Fla. 1974). A pledge of a security is considered a sale for purposes of these Acts. *Rubin* v. *U.S.*, ___ U.S. ___, 100 S.Ct. 698 (1981).

Authorities relied upon to claim that a CD is not a security within the Federal Securities Acts (*such as Canadian Imperial Bank of Commerce Trust Company* v. *Fing-*

land, 615 F.2d 465 (7th Cir. 1980) and others cited therein) all relate to the initial issuance of a CD where the courts have rejected the contention that the issuance is an "investment contract" within *S.E.C.* v. *Howey,* 328 U.S. 293 (1946). The secondary transfer of a bank CD for a loan providing risk capital with the expectation of profits is controlled by a separate line of cases because a loan providing risk capital with an expectation of profits is considered an "investment contract" or a securities transaction. A secondary sale of a bank CD with additional interest paid thereon as a bonus is a protected security transaction. *Safeway Portland Employees Federal Credit Union* v. *C.H. Wagner & Co., Inc.,* 501 F.2d 1120 (9th Cir. 1974). Loan transactions to revive an insolvent business are securities transactions. *S.E.C.* v. *Continental Commodities Corp.,* 497 F.2d 516 (5th Cir. 1974). Misrepresentations made with respect to the underlying collateral for a loan transaction have also constituted protected securities transactions. *El Khadem* v. *Equity Securities Corp.,* 494 F.2d 1224 (9th Cir. 1974), *cert. denied* 419 U.S. 900 (1974).

The Third Circuit also correctly reversed the District Court's dismissal of the claims premised on Pennsylvania law holding that the District Court had pendent jurisdiction over the state law claims in Weaver's Complaint. The Bank in its petition for certiorari to this Court has not raised the Third Circuit's reversal of the dismissal of the pendent claims under Pennsylvania law. Therefore, that holding is not presently before this Court for consideration. Rule 23(c), Rules of the Supreme Court; *Whirlpool Corp.* v. *Marshall,* 445 U.S. 1 (1980).

Should this Court review the pendent jurisdiction issue on its merits it would find that the Third Circuit correctly concluded that the District Court had pendent jurisdiction to hear the claims premised on Pennsylvania law and

that there were compelling reasons to have this case disposed of in one proceeding in the federal forum, *Rosado* v. *Wyman*, 397 U.S. (1970); *Borror* v. *Sharon Steel Company*, 327 F.2d 165 (3rd Cir. 1964). Even if this Court would conclude that there was no purchase and sale of a security within the Federal Securities Acts, it should remand this case to the District Court for further proceedings consistent with the Opinion of the Third Circuit reversing the District Court's grant of summary judgment in favor of the Bank.

ARGUMENT

I. WHETHER THERE WAS A GENUINE ISSUE OF MATERIAL FACT WITH RESPECT TO EITHER THE COLUMBUS PROFIT SHARING AGREEMENT OR THE WEAVER'S SIX YEAR CERTIFICATE OF DEPOSIT BEING A SECURITY INVOLVED IN A "SECURITIES TRANSACTION", PROTECTED BY RULE 10 b-5 OR SECTION 17(a) TO PRECLUDE SUMMARY JUDGMENT IN THE BANK'S FAVOR.

(A) Elements Of A Private Claim Under The Federal Securities Acts:

A private cause of action is implied under Rule 10 b-5 for a party similarly situated as the Weavers. *See Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). Private claims have also been implied under Section 17(a) of the 1933 Act. *Kirshner* v. *United States*, 603 F.2d 234, 241 (2nd Cir. 1978) *cert. denied*, 442 U.S. 909 (1979); *Newman* v. *Prior*, 518 F.2d. 97, 99 (4th Cir. 1975); *see generally* Hazen, *A Look Beyond the Pruning of 10(b)(5); Implied Remedies in Section 17(a) of the 1933 Act*, 64 Virginia Law Review 641, 648 (1978) (Footnote 35 and cases cited therein).[12]

[12] This issue was not addressed by the Court in *Aaron* v. *S.E.C.*, 446 U.S. 680, 689 (1980).

Face-to-face private securities transactions have been held to be within the scope of the protection of the anti-fraud sections of the Federal Securities Acts. *Matheson* v. *Armbrust,* 284 F.2d 670 (9th Cir. 1960), *cert. denied* 365 U.S. 870 (1961). The imposition of Rule 10 b-5 liability is not predicated on the transaction being conducted through a securities exchange or an organized national market. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 10 (1971).

The tenth Circuit in *Stevens* v. *Vowell,* 343 F.2d 374 (10th Cir. 1965), at page 378, summarized what a claimant must prove to establish a 10 b-5 claim, stating:

> It is, of course, the law that the burden is upon the plaintiff to establish jurisdiction, and coincidentally make out a case under the statute and rule and to do so he must prove: (1) use of the mails or instrumentalities of interstate commerce; (2) the purchase and sale of a security; and (3) the use of a manipulative or deceptive device.

Proof of a "manipulative or deceptive device" within the third element of *Stevens* v. *Vowell, supra,* must involve "(1) a misstatement or an omission, (2) of a material fact, (3) made with scienter, (4) on which the plaintiff relied, (5) that proximately caused his injury." *Huddleston* v. *Herman & MacLean,* 640 F.2d 534, 543 (5th Cir. 1981).

Rule 10 b-5 applies to both buyers and sellers of securities and those that aid and abet a purchase and sale; Section 17(a) is limited to sellers and aiders and abettors of sellers. *Crowell* v. *Pittsburgh & Lake Erie Railroad Company,* 373 F.Supp. 1303, 1311 (E.D. Pa. 1974). Scienter is required for a 10 b-5 violation, *Ernst & Ernst* v. *Hochfelder, supra,* Scienter is not required by Section

17(a), *Aaron* v. *S.E.C., supra.*[13] Rule 10 b-5 liability would extend to the Bank's purchase and sale, and secondary misconduct, with respect to the Columbus agreement and the CD. Section 17(a) liability would apply to the sale of the Columbus agreement and related secondary misconduct. If the two transactions are considered as one transaction, then these distinctions are not important. The District Court, in granting the Bank's motion for summary judgment, did not reach the following issues: (1) whether there was a misstatement or an omission of a material fact; (2) whether the statements were made with the required scienter; (3) whether channels of interstate commerce were affected; (4) whether the misstatements were made "in connection with" the purchase and sale of a security; and (5) whether there was any detrimental reliance by Weaver on the misrepresentations made by Marine.[14] There were sufficient facts in the record to preclude the District Court from granting summary judgment on those issues.

The District Court concluded that there was no genuine issue of a material fact as to whether the March 17, 1978 transaction made reference to above constituted a purchase and sale of a security and/or securities within either Federal Securities Act. Upon finding that there was no genuine issue of a material fact which would support a purchase and sale of a security within these Acts,

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[13] The Bank claims that the Weavers did not plead the requisite "scienter" in the complaint. This issue was never raised in the District Court or reviewed by the Third Circuit. Considering that Rule 9(b) of the F.R.C.P. does not require specific allegations regarding state of mind, the Weavers' complaint was sufficient. *Denny* v. *Carey*, 72 F.R.D. 574 (E.D. Pa. 1976).

[14] The Bank's brief, incorporated by reference as part of the District Court's Opinion, also failed to address any of these issues.

the Court ruled that a necessary jurisdictional element was lacking and dismissed the Weavers' case by holding that the Court lacked subject matter jurisdiction (PA-28).

(B) Standard Of Review For Considering The Propriety Of Granting Summary Judgment Pursuant To Rule 56 Of The Federal Rules Of Civil Procedure:

This case was decided by summary judgment pursuant to Rule 56(c) of the Federal Rules of Civil Procedure.[15] The Bank, as moving party, had the burden of proving that there were no genuine issues of material fact to support the Weaver's contention that there was a purchase and sale of a security as a consequence of the March 17, 1978 transactions. *United States ex rel. Jones* v *Rundle,* 453 F.2d 147 (3rd Cir. 1971).

If the facts and their inferences on the critical issues are disputed, after construing them most favorably in favor of the non-moving party, in this case, the Weavers, it is reversible error to grant summary judgment. *Adickes* v. *Kress & Company, Inc.,* 398 U.S. 144 (1970); *U.S.* v. *Diebold, Inc.,* 369 U.S. 654 (1962); *In Re: Consolidated Pre-Trial Proceedings In Antibiotic Antitrust Actions,* 538 F.2d 180 (8th Cir. 1976) *cert. denied,* 429 U.S. 1040 (1977).

Certain cases have traditionally been inappropriate for disposition by motions for summary judgment. *In Epprecht* v. *Delaware Valley Machinery, Inc.,* 407 F.Supp. 315 (E.D. Pa. 1976) a claim under 10 b-5, the Court discussed this burden at page 322, stating:

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[15] Rule 56(c) of the Federal Rules of Civil Procedure provides in part, ". . . the judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law."

> That burden (of proving the absence of a genuine issue of material fact) is especially heavy on a defendant who seeks summary judgment on the basis that a plaintiff has failed to create a genuine factual dispute as to such elusive concepts as motive, intent, conspiracy or knowledge. *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464, 82 S.Ct. 486, 7 L.Ed. 2d 458 (1962); *Adickes* v. *Kress & Company, Inc.*, 398 U.S. 144, 90 S.Ct. 1598, 26 L.Ed. 142 (1970).[16]

(C) The Columbus agreement to pay the Weavers 50% of the profits of Columbus could be found to be an "investment contract" or a "profit sharing agreement" or a "certificate of interest," and, therefore, a security within either of the Federal Securities Acts:

Columbus agreed, in writing, to grant the Weavers 50% of the "adjusted net profits" of Columbus.[17] This agreement was executed sometime between February 28, 1978 when the Weavers purchased their CD from the Bank and March 17, 1978 when the CD was pledged to the Bank.[18]

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[16] See discussion of summary judgment procedures in complex cases in *In Re: Consolidated Pre-Trial Proceedings in Antibiotic Antitrust Action*, 538 F.2d 184-185.

[17] That written agreement provided "2. While Piccirillo is operating and in possession of the Columbus Packing premises and until said $50,000.00 loan is paid in full by Piccirillo, Weaver shall have the following rights: . . . (b) to receive 50% of the 'adjusted net profits' of Columbus Packing Company at the conclusion of each fiscal year. The computation of the 'adjusted net profits' at the conclusion of each fiscal year shall be (1957) based on the percentage of days in the immediately preceding fiscal year during which Weaver was a co-obligor on the aforementioned indebtedness by Piccirillo" (JA-11).

[18] Sam Weaver described the purpose of the Columbus agreement, stating, ". . . It was a little share of the business, a little share of his profits in business, if he made any profits; he was giving us a little share in his business if we'd loan him a little working capital." (CA-319).

The Third Circuit, in reversing the District Court, held that there were genuine issues of material fact as to whether the Columbus profit sharing agreement was an "investment contract" with *S.E.C.* v. *Howey,* 328 U.S. 293 (1946) and *Tcherepnin* v. *Knight,* 389 U.S. 332 (1967), which precluded the grant of summary judgment under Rule 56 of the Federal Rules of Civil Procedure. Alternatively, the Court held that this agreement could be considered a "certificate of interest or participation in a profit sharing arrangement" (A-6) within the definition of a security under the Federal Securities Acts, citing *S.E.C.* v. *Addison,* 194 F.Supp. 709, 721-22 (N.D. Tex. 1961) and *William Tell Productions, Inc., S.E.C. Act. Rel.,* 3852 (1957). The definitions of security in the 1933 and 1934 Acts are virtually identical. *Tcherepnin* v. *Knight,* 389 U.S. 332, 342 (1967); *U.S. Housing Foundation, Inc.* v *Forman,* 421 U.S. 837, 847 (1975) (Footnote 12). The definitions include "investment contract," "profit sharing agreement," "certificate of interest" and "note." 15 USC § 77 b(1); 15 USC § 78 c(2)(10). The 1933 Act includes, as a security, "evidence of indebtedness," which term is not included in the 1934 Act.

Investment contract

An "investment contract," a form of a security within both statutory definitions, has been defined by the Court in *S.E.C.* v. *Howey, supra* at 298, 299, as:

> "(A) contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter of a third party, it being immaterial whether the share in the enterprise is evidenced by a formal certificate or by nominal interest in physical assets employed in the enterprise."

To meet the *Howey* test, an investment contract must involve an (1) investment of money or its equivalent; (2) in a common enterprise; (3) with the expectation of profits from the efforts of others. *Cameron* v. *Outdoor Resorts of America,* 608 F.2d 187, 192 (5th Cir. 1979); *Hector* v. *Wiens,* 533 F.2d 429, 432, 433 (9th Cir. 1976); *see also* FitzGibbon, *What is a Security? A Redefinition based upon the Eligibility to Participate in Financial Markets,* 64 Minn. L. Rev. 898-908 (1980).

(1) *Investment of money.* There is little doubt that, if the Weavers had given Columbus $50,000.00 in exchange for Columbus' agreement to grant 50% of the profits of Columbus to the Weavers, and it was understood between the parties that the $50,000.00 was for working capital, that the investment of money requirement for an investment contract would be satisfied. *S.E.C.* v. *Glenn Turner Enterprises, Inc.,* 474 F.2d 476 (9th Cir. 1973), *cert. denied,* 414 U.S. 82 (1973). A "substance-over-form" analysis must be applied in determining whether or not the requirement of an investment contract have been met. *S.E.C.* v. *Howey Co., supra* at 299; *Tcherepnin* v. *Knight, supra* at 336.

The Ninth Circuit in *Hector* v. *Wiens, supra* at 432 discussed the investment of money requirement of the *Howey* test and stated:

> . . ., an investment of money means only that the investor must commit his assets to the enterprise in such a manner as to subject himself to financial loss. *El Khadem* v. *Equity Securities Corp.,* 494 F.2d 1224 (9th Cir. 1974), *cert. denied,* 419 U.S. 900 (1974).

The execution of promissory notes in *Hector* v. *Wiens, supra* was found to constitute an "investment of money" within this requirement, *Id.* at 432. Considering that the Weavers' risk of loss of the CD was dependent upon the

success of Columbus, this pledge constituted an investment of money within the *Howey* test.

International Brotherhood of Teamsters v. *Daniel*, 439 U.S. 551 (1979) is clearly distinguishable from the present case. There a retirement fund was created out of contributions made by employers. The claim was that the retirement fund constituted a security. There was no specified amount of money or property which could have constituted an "investment in money" in the same fashion that the Weavers' CD was recognized by the Bank to be the Weavers' investment in Columbus. In holding that the retirement fund was not a security, the Court stated:

> In every decision of this Court recognizing the presence of a "security" the person found to have been an investor chose to give up a specific consideration in return for a separable financial interest.

Id. at 559-60. The Weavers pledged their CD for the right to receive 50% of the profits of Columbus (See Footnote 17).

(2) *Common enterprise.* The Ninth Circuit in *Hector* v. *Wiens, supra* at 433 held that vertical commonality is all that is required to satisfy the common enterprise element; and that horizontal commonality, or multiple investors, are not required for an investment contract.[19] A single investor and one promotor satisfies the commonality requirement. *S.E.C.* v. *Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974); *Rochkind* v.

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[19] See discussion of vertical and horizontal commonality in *Securities Investor Protection Corp.* v. *Associates Underwriters, Inc.*, 432 F.Supp. 168, 178 (D. Utah 1975); *Troyer* v. *Karcagi*, 476 F.Supp. 1142, 1147 (N.D. N.Y. 1979) (where a requirement of horizontal commonality is discussed and rejected as a necessary ingredient of a common enterprise within the *Howey* test.

Reynolds Securities, Inc., 388 F.Supp. 254 (D. Md. 1975) (and cases cited therein).

The contracts involving the delivery of commodities in the future, such as that in *Hirk* v. *Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977); *Milnarik* v. *M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972); and *Wasnowic* v. *Chicago Board of Trade*, 352 F.Supp. 1066 (M.D. Pa. 1972), are significantly different than the agreement between the Weavers and Columbus to share the profits of Columbus. The commodity speculator's chances of making a profit and the promotor's, or broker's chances of making a profit or commission are not dependent on each other or any other investor. The commodity speculator can lose money while the broker or the promoter, in this context, can make money. On the other hand, the Weavers' chances of making a profit were the same as Columbus' chances, which were dependent upon Columbus combining its assets and labor with the Weavers' working capital. The pooling of the Weavers' capital with Columbus' assets and labor satisfies the vertical commonality test and whatever, if any, horizontal commonality that is required for an investment contract.

(3) *Expectation of profits from the efforts of others.* To satisfy the third test of the *Howey* definition for investment contracts, the investor must expect profits from the efforts of others as a result of his investment. The Ninth Circuit in *S.E.C.* v. *Glenn Turner*, 474 F.2d 476, 482 (9th Cir. 1973), *cert. denied*, 414 U.S. 82 (1973), held that, so long as the promoter performed the "essential managerial" efforts, the third requirement for an investment contract was satisfied, even though the investor may be required to contribute labor or effort on behalf of the enterprise. If Columbus had produced a profit, it would have resulted largely from Piccirillo's efforts and

any contribution that the Weavers would have made, other than providing working capital, would have been slight considering their advanced age.

The Columbus agreement giving the Weavers a share of the profits, also gave the Weavers grazing rights.[20] Based on this provision and based on the Bank's suggestion that the Weavers had an expectation of getting some cattle auction business from Columbus in consideration for this agreement, the Bank contends that the Weavers were not expecting profits from the efforts of others within the *Howey* rule. Sam Weaver unequivocally testified that the consideration for the pledge to the Bank and the loan to Columbus, was a share in the Columbus business and profits. Because the Weavers are entitled to all of the favorable inferences in a motion for summary judgment, and because the Bank failed to offer any evidence whatsoever to quantify consideration, other than profits, received by the Weavers, the third element of the *Howey* test was satisfied.

Profit sharing agreement or certificate of interest

Besides finding that the Columbus agreement could be found to be an investment contract, the Third Circuit also found that the Columbus agreement could constitute a "certificate of interest or participation in any profit sharing agreement," both of which fall within the definition of security under the Federal Securities Acts. The Columbus agreement clearly represented an agreement between the Weavers and Columbus to share the profits of Columbus and was within the definition of prof-

[20] This agreement allowed the Weavers "to use the barn and pastures located in the Columbus Packing Company premises in Columbus Township, Warren County, Pennsylvania at the discretion of Piccirillo" (JA-11).

it sharing agreement. *S.E.C* v. *Addison*, 194 F.Supp. 709, 721-222 (N.D. Tex. 1961); *see also 1 Loss, Securities Regulation*, 489 (2d ed. 1961) (relied upon by the Third Circuit in arriving at this conclusion) (A-6).

The Court in *Crowell* v. *Pittsburgh & Lake Erie Railroad Company*, 373 F.Supp. 1303, 1309 (E.D. Pa. 1974), defined a certificate of interest, stating:

> In this case, the investors have provided financing for the purchase of cars in return for which they expect profits which result from Pittsburgh and Lake Erie efforts.

The Weavers provided working capital for Columbus through the Bank in consideration for what Weaver described as a "little share of his profits" (see footnote 18). A participation in a loan agreement with the expectation of profits is a security within the 1934 Act. *Lehigh Valley Trust Company* v. *Central National Bank of Jacksonville*, 409 F.2d 989 (5th Cir. 1969).

After construing the record facts most favorably to Weaver, as required by the applicable standard of review in a summary judgment proceeding, *U.S.* v. *Diebold, Inc.*, 369 U.S. 654 (1962), there were genuine issues of material fact that preclude a finding, as a matter of law, that the Columbus agreement was not an investment contract, a profit sharing agreement, or a certificate of interest within the definition of security in either the 1933 or 1934 Acts. The Third Circuit was correct in reversing the District Court and remanding this case to the District Court for further proceedings in accordance with its Opinion.

(D) There Were Genuine Issues Of Material Fact Regarding The Bank's Role With Respect To The Sale Of The Columbus Agreement To The Weavers Either Under A Theory Of Primary liability Or Under A Theory Of Secondary Liability, Thereby Precluding The Grant Of Summary Judgment In Favor Of The Bank.

The Weavers' claim against the Bank with respect to its liability for the Columbus agreement was twofold. First, the Bank's possession of all of the pertinent financial information of Columbus implicates the Bank either as an "insider" within *S.E.C.* v. *Texas Gulf Sulphur Company*, 401 F.2d 833 (2nd Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) or Columbus' "investment banker" as in *In Re: Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), thereby imposing primary liability for misrepesentations made in connection with inducing the Weavers to invest in Columbus.

The Weavers also claim that the Bank was secondarily liable as an "aider and abettor" within *Monsen* v. *Consolidated Dressed Beef Company, Inc.*, 579 F.2d 793, 800 (3rd Cir. 1978); RS 2d, Torts, § 876; *Zabriskie* v. *Lewis*, 507 F.2d 546, 533-4 (10th Cir. 1974); or secondarily liable as a "professional consultant" within *Crofoot* v. *Sperry Rand Corp.*, 408 F.Supp. 1154, 1157 (E.D. Cal. 1976); or "substantially involved" in the affairs of Columbus when making the misrepresentations to the Weavers calculated to induce their investment in Columbus. *Zweig* v. *Hearst Co.*, 594 F.2d 1261 (9th Cir. 1979).

The Bank claimed in the District Court, the Third Circuit Court of Appeals, and this Court that because it had no direct knowledge of the sale of the Columbus agreement to the Weavers this precluded imposition of either primary or secondary liability. The Third Circuit reversed the District Court's holding on this issue stating (A-9):

> "(A) fact finder could have found that the Bank engaged in material and deceptive acts or practices in connection with the purchase by Weaver of a contract for a 50% share in the profits of Columbus . . ."

The Weavers claimed that the Bank, having all of the inside financial information of Columbus and, therefore, having full knowledge of Columbus' insolvency, made material affirmative misrepresentations to the Weavers, individuals known to the Bank as potential investors in Columbus, for purposes of soliciting the Weavers to invest in Columbus through the Bank. The Bank intended to "enhance its position"[21] with respect to the Bank's outstanding loans and overdrafts of Columbus, as "enhancement" is described by the Third Circuit in a Rule 10 b-5 case against a bank in *Monsen* v. *Consolidated Dressed Beef Company, Inc., supra* at 803, footnote 17.

The Weavers are entitled to recision if the required elements of a 10 b-5 or 17(a) violation have been established. *Gordon* v. *Burr,* 506 F.2d 1080 (2nd Cir. 1974); *G & M, Inc.* v. *Newbern,* 488 F.2d 742 (9th Cir. 1973). As a purchaser and/or a seller of a security, the Weavers had standing to bring a claim under either Rule 10 b-5 or Section 17(a). *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). Classifying the Bank as a seller is not a prerequisite to recognition of the Weavers' cause of action. The Second Circuit in *Bartege* v. *Barnett,* 553 F.2d 290, 291 (2nd Cir. 1977) stated:

> (T)he rule does not require that defendant be the seller of the stock or that plaintiff have purchased the stock from defendant.

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[21] A bankruptcy of Columbus in March, 1978 would have relegated the Bank to an unsecured creditor status. The pledge of the CD by the Weavers allowed the Bank to "enhance its position" and usurp a priority over other secured and priority liens (see footnote 6).

The Ninth Circuit had previously addressed this question in *G & M, Inc.* v. *Newbern*, 488 F.2d 742, 745 (9th Cir. 1973), and held:

> A plaintiff who is induced to buy or sell stock as a result of misrepresentations made by someone not a party to the sale may sue that person for damages incurred as a result of the sale . . .

When a bank actively attempts to secure investment capital for one of its customers it is acting in the capacity of an "investment banker." *In Re: Cady, Roberts & Co.*, 40 S.E.C. 907, 913 (1961). When an investment banker makes affirmative material misrepresentations to a potential investor and these material misrepresentations cause the sale of a security, liability is imposed under the Federal Securities Acts. *Id.; Ross* v. *Licht*, 263 F.Supp. 395 (S.D. N.Y. 1967). Considering the Bank's role in Columbus in its entirety, and construing the facts most favorably toward the Weavers', a fact finder could find that the Bank was acting as an "insider" within *S.E.C.* v. *Texas Gulf Sulphur Company*, 401 F.2d 833 (2nd Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); or an investment banker within *In Re: Cady, Roberts & Co., supra.*

Liability has been imposed against a wide range of professional consultants who, while in possession of inside information of a client, made material misrepresentations to third parties involved in a purchase and sale of a security or an investment transaction with that customer.[22]

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[22] Liability has been imposed against a lawyer; *Katz* v. *Amos Treat & Co.*, 411 F.2d 1046 (2nd Cir. 1969); against accountants, *Heit* v. *Weitzen*, 402 F.2d 909 (2nd Cir. 1968); *Spectrum Financial Company* v. *Marconsult*, 608 F.2d 377 (9th Cir. 1979); and against banks, *Carroll* v. *First National Bank of Lincolnwood*, 413 F.2d 353 (7th Cir. 1969). A bank was found liable as an aider and abettor in *Monsen* v. *Consolidated Dressed Beef Company, Inc.*, 579 F.2d 793, 800 (3rd Cir.

The courts in imposing secondary liability in security transactions have not limited liability to aiders and abettors, as those terms are defined in *Monsen* v. *Consolidated Dressed Beef Company, supra* at 800. Secondary liability under 10 b-5 has been imposed upon a party acting as a co-conspirator in *Ferguson* v. *Omnimedia, Inc.*, 469 F.2d 194 (1st Cir. 1972). *In Zabriskie* v. *Lewis*, 507 F.2d 546, 553-54 (10th Cir. 1974), the Tenth Circuit stated:

> The words acting in concert would indicate a finding of participation of multiple actors and liability imposed on participants if their participation is substantial.

Liability could be imposed against the Bank in the present case as a "mutual actor" as in *Crofoot* v. *Sperry Rand Corp.*, 408 F.Supp. 1157 (E.D. Cal. 1976).

The Weavers suggest that a pragmatic approach to the identification of a party secondarily liable for material misrepresentations made in connection with the purchase and sale of a security is the "flexible duty" standard developed by the Ninth Circuit in *White* v. *Abrams*, 495 F.2d 724, 730-1 (9th Cir. 1974).[23]

1978). A bank acting as a professional consultant and involved in the solicitation of capital was found liable to a farmer in closely similar circumstances as the present case. *Hector* v. *Wiens*, 533 F.2d 429 (9th Cir. 1976).

[23] The Ninth Circuit in *Zweig* v. *Hearst Company*, 594 F.2d 1261, 1268 (9th Cir. 1979) summarized the important factors in determining the disclosure duty under Rule 10(b)-5 as:

> (1) the relationship of the defendant to the plaintiff; (2) defendant's access to the information as compared to that of the plaintiff; (3) defendant's benefit derived from the relationship; (4) defendant's awareness of whether plaintiff was relying on the relationship in making his or her investment decisions; and (5) defendant's activities in initiating the transaction. Scienter is also required. *Id.* at 1268, footnote 13.

There were genuine issues of a material fact which would preclude the entry of summary judgment in the Bank's favor applying the "flexible duty" standard. First, the relationship of the Bank to the Weavers was that part of a purchaser and seller of a CD and that of a potential investor in Columbus and an insider of Columbus. Secondly, the Bank had access to all of the financial information of Columbus and the Weavers had none. Thirdly, the Bank derived great benefit from a sale of an investment interest in Columbus to the Weavers as this allowed the Bank to "enhance its position" and secure a loan which was previously unsecured and correct a continuing overdraft problem it had with Columbus. Fourthly, the Bank was fully aware that it had superior information with respect to Columbus, and that the Weavers were relying upon the Bank for advice on their "investment" decision and to continually monitor the financial affairs of Columbus thereafter. Lastly, the Bank actively and frequently solicited the Weavers to engage in this transaction.

The Bank claims it lacks specific "knowledge" of the Columbus profit sharing agreement preventing a finding that it is either primarily or secondarily liable for the purchase and sale of that agreement. Corporate knowledge of the Columbus agreement by the Bank could be inferred from the circumstantial evidence developed at a full trial. *See Securities and Exchange Commission* v. *Coffey,*

Previously the Ninth Circuit in *White* v. *Abrams, supra* at 736, discussed the rationale for the "flexible duty" standard stating:

> Where the defendant derives great benefit from a relationship of extreme trust and confidence with the plaintiff, the defendant knowing that plaintiff completely relies upon him for information to which he has ready access, the law imposes a duty upon the defendant to use extreme care in assuring that all material information is accurate and disclosed. If the defendant has breached this duty he is liable under Rule 10(b)-5 provided the elements of materiality, causation and damages are established.

493 F.2d 1304, 1317 (6th Cir. 1974). Construing the facts and inferences most favorably to the Weavers, an inference can be drawn that the Bank recognized the Weavers as "investors" who were given consideration by way of a share of the profits and business of Columbus as a consequence of their agreement to pledge their $50,000.00 CD for this purpose.

The First Circuit in *Ferguson* v. *Omnimedia, Inc., supra* at 196-7 reversed a District Court's grant of summary judgment, where the District Court held that a party charged as a co-conspirator or as an aider and abettor in a securities violation knew of a balance sheet which was the subject matter of that case. The First Circuit held there was sufficient circumstantial evidence to allow a finding that the defendant had knowledge of the balance sheet. More importantly, the Court held that where the issue of knowledge is largely based upon circumstantial evidence and the facts are largely within the control of the moving party, summary judgment is inappropriate and not a "sufficient substitute for trial." *Id.* at 198.

Other courts in Federal Securities Acts cases have found the requisite guilty knowledge to impose secondary liability from the totality of the circumstances. *Trussel* v. *Underwriters Ltd.*, 228 F.Supp. 757 (D. Colo. 1964); *Brennan* v. *Midwestern United Life Insurance Company,* 259 F.Supp. 673 (N.D. Ind. 1966), 286 F.Supp. 702 (N.D. Ind. 1968), *aff'd* 417 F.2d 147 (7th Cir. 1969), *cert. denied* 397 U.S. 389 (1970).

The Weavers claim there are genuine issues of material fact as to whether the Bank was acting as an "insider" of Columbus within *S.E.C.* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2nd Cir. 1968), *cert. denied* 394 U.S. 976 (1969); or like Columbus' "investment banker" within *In Re: Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); or as an

"aider and abettor" to Columbus' sale of this agreement, *Monsen* v. *Consolidated Dressed Beef Company, Inc.*, 579 F.2d 793 (3rd Cir. 1978); or liable under any of the theories of secondary liability such as a "professional consultant" or "mutual actor" as those terms are defined in *Crofoot* v. *Sperry Rand*, 408 F.Supp. 1157 (E.D. cal. 1976). Applying the Ninth Circuit's "flexible duty" standard in *White* v. *Abrams*, 495 F.2d 724 (9th Cir. 1974), there are genuine issues of material fact to support the contention that the Bank was "substantially involved" in Weavers' investment transaction in Columbus so as to impose liability under this standard.

(E) There Were Genuine Issues Of Material Fact As To Whether The Weavers' Pledge Of Their CD Was A "Securities Transaction" And, Therefore, A Purchase And Sale Of A Security Within The Anti-Fraud Provisions Of The 1933 or 1934 Acts To Preclude This Issue From Being Resolved By Way Of Summary Judgment.

The District Court held, as a matter of law, that the CD which the Weavers pledged to the Bank on March 17, 1978 was not a security within either the 1933 or 1934 Acts.[24] In granting summary judgment, the District Court held (PA-28):

> The transaction was nothing more than an ordinary commerical transaction entered into by borrowers and co-obligors such as the Weavers with security given the lender by one of the co-obligors, that is the Weavers, the plaintiff in this case.

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[24] The Weavers' claim with respect to the CD and the application of Section 17(a) was properly and timely raised in the Weavers' answer to the Bank's motion for summary judgment, and contrary to the Bank's assertion, the District Court considered the Weavers' Certificate of Deposit claim under Section 17(a) on its merits (See footnote 2).

The Third Circuit, in addition to its holding that there were fact issues as to whether the Columbus agreement was an investment contract, held that there were issues relating to this CD which precluded a finding, as a matter of law, that it was not a security or part of a securities transaction within the 1934 Act. The Third Circuit held that a pledge of a CD constituted a sale, citing *Mallis* v. *F.D.I.C.*, 568 F.2d 824, 829-30 (2nd Cir. 1977), *cert. dismissed sub nom, Bankers Trust Company* v. *Mallis*, 435 U.S. 381 (1978) (PA-10). The Third Circuit correctly predicted that this Court would hold that a "pledge" constituted a purchase and sale of a security as the terms "purchase and sale" are used in the 1933 and 1934 Acts. *Rubin* v. *U.S.*, ___ U.S. ___, 100 S.Ct. 698 (1981).

The Weavers' six year CD, having a maturity in excess of nine months, was, according to the Third Circuit, ". . . in all material respects . . . (the) functional equivalent of any other corporation's bond or note . . ." and thus, the Court stated that, ". . . we cannot on this record hold that a certificate of deposit evidencing its debt is not, like other long term bonds or notes, a security," (PA-12). The Third Circuit followed the direction of the Fifth Circuit in *Bellah* v. *First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974)[25] and remanded this matter to the District Court ". . . so as not to foreclose them from an opportunity to pursue that theory of liability in the District Court." (PA-12).

The protection afforded by the 1933 and 1934 Acts is remedial. It is not focused on "securities" in the abstract. Rather, it is designed to protect "investors" from trading

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[25] *Bellah* has been cited by the Bank for the proposition that a CD is not a security. However, the Comments of the *Bellah* Court on the CD issue were dicta and the case was remanded to allow the plaintiffs to pursue the CD theory, *Id.* at 1116.

in securities in reliance upon material misrepresentations and the manipulative and deceptive devices of others. As stated by this Court in *United States Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975): "The need for regulation to prevent fraud and to protect the interests of investors" was the purpose of this legislation. The Second Circuit previously stated that, "The act is for the protection of investors and its provisions must be read accordingly." *Movielab, Inc.* v. *Berkey Photo, Inc.*, 321 F.Supp. 806 (S.D. N.Y. 1970) (corporate notes were held to be securities because, in part, they evidenced an investment); *Zeller* v. *Bogue Electric Mfg. Co.*, 476 F.2d 795 (2nd Cir. 1973) (corporate demand note was found to be a security).

The definition of security within the context of either the 1933 or 1934 Act should be subordinate to identifying an investor making an investment transaction or "securities transaction." As the Court cautioned in *United States Housing Foundation, Inc.* v. *Forman, supra* at 849, a "literal approach" should not be followed in defining security; rather, the "economic realities underlying a transaction" should be examined for the purpose of affording protection to an investor making an investment transaction against misrepresentations and manipulative devices used by others to induce such a transaction. The Court in *Forman, supra* at 859-860, identified those who are entitled to the protection of these Acts, stating:

> What distinguishes a "securities transaction" — what is absent here — is an investment where one parts with his money in the hopes of receiving profits from the efforts of others.

A six year CD issued by a bank is literally "any note" or "evidence of indebtedness" within these terms as

used in the definition of security in the 1933 Act, or "any note" as that term is used in the 1934 Act.[26]

In holding that a CD or a bank time deposit having a maturity date greater than nine months is a security within either the 1933 or 1934 Acts, the Third Circuit did not break new ground. The District Court found a CD to be a security in *Garner* v. *Pearson*, 374 F.Supp. 591, 596 (M.D. Fla. 1974). Likewise, the District Court in *Superintendent of Insurance of State of New York* v. *Bankers Life & Casualty Co.*, 300 F.Supp. 1083, 1100 (S.D. N.Y. 1969), *rev'd on other grounds*, 404 U.S. 6 (1971), held that a CD could be a "note" within either Act or "evidence of indebtedness" within the 1933 Act.[27] Applying the "commercial-investment dichotomy," the Fifth Circuit found that time certificates of deposit issued by a Bahamian Bank and sold by the Bank of Miami were arguably securities in *Meason* v. *Bank of Miami*, ____ Fed.2d ____ (5th Cir., August, 1981); *but cf. Ayala* v. *Jamaica Savings Bank*, ____ F.Supp. ____ (E.D. N.Y. 1981) (where the court held that the *issuance* of a time deposit was not a security or a "securities transaction").

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[26] The Third Circuit did not hold that this CD was a security because it fell within the phrase "certificate of deposit, for a security," even though there is authority to support that contention. Because this CD's maturity date substantially exceeds nine months, it does not qualify for the exception in the 1934 Act which states, "but shall not include currency or any note, draft, bill or exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months . . ."

[27] Related holdings were made in *Securities and Exchange Commission* v. *First American Bank & Trust Co.*, 481 F.2d 673 (8th Cir. 1973) (capital notes, certificates of investment and passbook savings accounts of a state-regulated bank); *Young* v. *Seaboard Corp.*, 360 F.Supp. 490 (D. Utah 1973) (savings accounts and certificates of deposit of a bank); *MacKethan* v. *Peat, Marwick, Mitchell & Co.*, 439 F.Supp. 1090 (E.D. Va. 1977) (certificates of investment in industrial loan bank).

The Bank and the American Bankers Association argue that any CD issued by a F.D.I.C. bank is exempt from being a security within either the 1933 or 1934 Acts, irrespective of its being traded for investment purposes in a secondary transaction. For the most part, their position is represented by the thinking of the Court in *Ayala* v. *Jamaica Savings Bank, supra.* The United States, on the other hand, concedes that a CD is within the literal definition of security of either Act and that there are transactions where a CD would be a security and protected by 10 b-5 and 17(a) but in the "context" of this case, the Weavers' CD was not such a security.

The Weavers claim that there are transactions where CDs are purchased and sold for investment in secondary transactions after issuance, which are "securities transactions" within *United States Housing Foundation* v. *Forman,* 421 U.S. 837 (1975). Applying a transactional analysis to this case, it could be found that the Weavers were investing risk capital in Columbus by way of their pledge to the Bank with the expectation of profits as the consideration for their pledge. The Bank's alleged lack of knowledge of the Columbus agreement and the fact that the Weavers had an expectation of profits, are facts to be considered with many others in determining whether the Bank is liable for material misrepresentations in connection with a "securities transaction," but not whether, in the first instance, there is a protected "securities transaction."

No Circuit Court has formulated a "litmus test" as to when a transaction involving a CD corporate note, or similar debt instrument is a purchase and sale of a security. *In Lino* v. *City Investing Co.,* 487 F.2d 689 (3rd Cir. 1969), the Third Circuit stated: ". . . (t)he courts will have to consider the complete context of each transaction" to make this determination, 487 F.2d at 696,

footnote 5. In an issuance case — not presenting the issue of a secondary transaction, as in the instant action — the First Circuit advised that "the paramount concern in the inquiry is upon the nature of the transaction in which the note is issued." *S.E.C.* v. *Continental Commodities,* 497 F.2d 516, 525 (5th Cir. 1974). The Second Circuit has indicated that when the maturity of the debt instrument falls literally within the definition of a security which exceeds nine months, the burden is upon the party claiming that the debt instrument is not a security to prove that the context of the transaction was not a "securities transaction." *Exchange National Bank* v. *Touche Ross & Co.,* 544 F.2d 1126, 1137-38 (2nd Cir. 1976).

Debt instruments traded for purposes of providing capital for a new business were found to be securities in *Movielab, Inc.* v. *Berkey Photo, Inc.,* 321 F.Supp. 806 (S.D. N.Y. 1970), *aff'd,* 452 F.2d 622 (2nd Cir. 1971). Likewise, the Court has held that a note was a security in *Barthe* v. *Risso,* 384 F.Supp. 1063 (S.D. N.Y. 1974). Where notes are issued on the basis of inadequate collateral which materially affects the risk to the note holder, the sale is a security transaction protected by the Federal Securities Acts. *El Khadem* v. *Equity Securities Corp.,* 494 F.2d 1224 (9th Cir. 1974); *Lehigh Valley Trust Company* v. *Central National Bank of Jacksonville,* 409 F.2d 989 (5th Cir. 1969).

A secondary sale of certificates of deposit where the inducement was the payment of a small fraction of interest over the interest called for in the CD has been held to be a purchase and sale of a security. *Safeway Portland Employees Federal Credit Union* v. *C.H. Wagner & Co., Inc.,* 501 F.2d 1120 (9th Cir. 1974). The Ninth Circuit in *Great Western Bank* v. *Kotz,* 532 F.2d 1252, 1258 (9th Cir. 1976), identified multiple factors, such as maturity time, collateralization, and risk to be considered in determin-

ing whether a loan transaction is an investment transaction; there are sufficient facts in the present case to satisfy this standard and allow the Court to hold that the Weaver transaction would be considered an investment transaction.[28]

There is evidence that the issuance of the CD to the Weavers on February 28, 1978 was part of the process whereby the Weavers invested in Columbus because of the solicitations by Columbus and the Bank prior to that date. The Weavers' pledge on March 17, 1978 was intended by the Weavers to achieve an investment position in Columbus to obtain a "little share of the business" and a "little share of his profits." The Bank was fully aware that the Weavers were acting as "investors" in Columbus by pledging their CD. The Bank was fully aware that the purpose of this transaction was to generate capital to resuscitate the failing business of Columbus, and, as such, similar to the purpose underlying the security transaction in *S.E.C.* v. *Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974).[29]

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[28] Under analogous circumstances, a secondary investment transaction involving a certificate of deposit issued by a bank was found to be an investment contract within *S.E.C.* v. *W.J. Howey Co.*, 328 U.S. 293 (1946). *Swank Federal Credit Union* v. *C.H. Wagner & Co., Inc.*, 405 F.Supp. 385, 389 (D. Mass. 1975).

[29] As John Daggett, the Bank officer having the most contact with the Weavers and Columbus with respect to this transaction, stated: ". . . Without capital, without any money put into this business it really would not be able to exist very much longer, Tony needed to have capital in the business (CA-135) . . ." capital had to be injected in the business, something had to be done to bring this thing around. Tony came to me with an investor, that investor being Sam Weaver (CA-130) . . . well, in general, that he (Piccirillo) had someone who may be interested in investing in his business and that person was Sam Weaver (CA-133, 134). . . .If the loan could be restructured under the proper amount of money being invested, that Marine

Authorities relied upon by the Bank, such as *Canadian Imperial Bank of Commerce Trust Company* v. *Fingland*, 615 F.2d 465 (7th Cir. 1980); *Burrus, Cootes & Burrus* v. *MacKeithan*, 537 F.2d 1262 (4th Cir. 1976), *withdrawn as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977); *Bellah* v. *First National Bank of Hereford, Texas*, 495 F.2d 1109 (5th Cir. 1974); and *Ayala* v. *Jamaica Savings Bank*, ___ F.Supp. ___ (E.D. N.Y. June, 1981), all relate to the *initial* issuance of a CD (similar to the first part of the transaction in this case when the Weavers' CD was issued by the Bank on February 28, 1978.) With respect to issuance, those courts rejected the concept that the initial issuance constitutes an "investment contract" within the definition of a security because there is no expectation of profits within *S.E.C.* v. *W.J. Howey, supra*, and the risk, if any, is minimal. But *none* of these cases involve a *secondary* pledge or sale of a CD where the sale or pledge, like the Weavers' was providing risk capital in consideration for the expectation of profits.

A note whose purpose is to generate risk capital constitutes a securities transaction protected by Rule 10 b-5 or Section 17(a) if it is given to revive a failing business. *S.E.C.* v. *Continental Commodities Corp., supra.* Misrepresentations as to collateralization of a long term loan which changed the character of the loan from one that was relatively safe to one having substantial risk have been found to involve 10 b-5 liability in connection with

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would be willing (to loan Piccirillo some money) to do this, yes (CA-147) . . . My conversation with him was very general in his (Weaver) investment and what collateral he (Weaver) could use (CA-14) . . . I tried to explain to him (Weaver) to the best of my ability the various ways that (Weaver) could become involved in the loan if he wanted to . . . and that is he came down to the dollar amount, the cash amount, by bringing in the Certificate (the $50,000.00 CD). (CA-131).

an investment transaction. *El Khadem* v. *Equity Securities Corp., supra.* The Weavers were providing risk capital within the standards set forth by the Ninth Circuit in *Great Western Bank & Trust* v. *Kotz,* 532 F.2d 1252 (9th Cir. 1976), and this three-way transaction, considered in its entirety, constituted a securities transaction similar to those in *Hector* v. *Wiens,* 533 F.2d 429 (9th Cir. 1976) and *Safeway Portland Employees Federal Credit Union* v. *C.H. Wagner & Co., Inc.,* 501 F.2d 1120 (9th Cir. 1974).

The Weavers' six year CD was literally within the definition of a security in either the 1933 or 1934 Acts. The secondary transaction of the Weavers' pledge of their CD to the Bank on March 17, 1978 was an investment or securities transaction because the Weavers were, in effect, providing risk capital to Columbus with an expectation of profits. The Bank made several material misrepresentations to the Weavers which gave them the illusion that this transaction was relatively safe when, in fact, it was fraught with risk. There were genuine issues of material fact relating to whether this pledge was the purchase and sale of a security in a securities transaction which preclude the grant of summary judgment in favor of the Bank on this theory of liability.

II. EVEN IF IT SHOULD FIND NO PURCHASE AND SALE OF A SECURITY WITHIN THE FEDERAL SECURITY ACTS, THIS COURT SHOULD REMAND THIS CASE TO THE DISTRICT COURT SO THAT THE DISTRICT COURT CAN RESOLVE THE PENDENT STATE CLAIMS IN ACCORDANCE WITH THE ORDER OF THE THIRD CIRCUIT COURT OF APPEALS.

The District Court, in dismissing the federal claims, also dismissed the state claims premised upon Pennsylvania law under Counts Two and Three of the Weavers' complaint. In doing so, the District Court relied upon the

holding of *Lentino & Flame* v. *Fringe Employee Plans, Inc.*, 611 F.2d 474 (3rd Cir. 1979). It concluded that because it found no purchase and sale of a security within the Federal Acts, and because there was no diversity of citizenship between the parties, it lacked jurisdiction to resolve the claims premised on Pennsylvania law (PA-27, 28). The Third Circuit reversed the District Court's dismissal of the claims premised on Pennsylvania law and held that there were compelling reasons why the District Court should resolve the state claims in one proceeding (PA-13 - 15).

The Weavers claimed that the actions and misrepresentations of the Bank giving rise to the claims under Rule 10 b-5 and Section 17(a) also gave rise to claims under the Pennsylvania Securities Act and Pennsylvania common law. The Pennsylvania Securities Act provides for a private action for recovery of damages for material misrepresentations in connection with a purchase and sale of a security. See 70 Purdons Stat. Ann. §1-501 (1980). The Acts' anti-fraud provisions are similar to those at Rule 10 b-5 and Section 17(a) of its federal counterparts. The state Acts' definition of an "insider" is similar to that which has evolved under federal case law. See 70 Purdons Stat. Ann. §1-401 (1980).

Pennsylvania common law provides for a private recovery for fraud and deceit. *See generally, Shane* v. *Hoffman*, 227 Pa. Super 76, 324 A.2d 532 (1974); *see also United Insurance Company of America* v. *B.W. Rudy, Inc.*, 42 F.R.D. 398 (E.D. Pa. 1967) (where the Court summarizes the elements of a fraud and deceit claim). Outside of the necessity of proving an effect on interstate commerce, and that a purchase and sale of a security was made within the definition of security of the Federal Acts, the proof underlying the claims set forth in Counts

Two and Three was the same as that required in proving a cause of action under Rule 10 b-5 or Section 17(a).

The Bank, in their petition for certiorari to this Court, and in their supporting brief, never raised the pendent jurisdiction issue. Therefore, the Third Circuit's resolution of that issue favorable to the Weavers is not before the Court at the present time. Rule 23(c), Supreme Court Rule. *In Whirlpool Corp.* v. *Marshall,* 445 U.S. 1 (1980) at page 161, Footnote 10, this Court recently stated:

> In its petition for certiorari, the petitioner did not cite this aspect of the Court of Appeals' decision as raising a question for review. Accordingly, the issue of whether the regulation covers the particular circumstances of this case is not before the Court. Sup. Ct. R. 23(c); *General Pictures Co.* v. *Electric Co.,* 304 U.S. 175, 177-179, 82 L.Ed. 1273, 58 S.Ct. 849.

Even if this Court would choose to review the Third Circuit decision on the pendent jurisdiction issue, it should conclude that the Court of Appeals correctly decided that issue in the context of this case. The general rule is that when there is one cause of action based upon two grounds, one federal and one state, the federal court shall retain jurisdiction to hear the related state claims if the federal claim was not plainly wanting of substance when it was filed. *United Mine Workers of America* v. *Gibbs,* 383 U.S. 715 (1966). Even though the federal claim may be resolved prior to trial, the Courts have held that the federal court has jurisdiction to resolve the related state law claims if, at the time of the filing, the federal claim was not plainly lacking in substance or "insubstantial." *Borror* v. *Sharon Steel Company,* 327 F.2d 165 (3rd Cir. 1964).

In Hagans v. *Levine,* 415 U.S. 528, 536 (1974), this Court previously indicated:

> the question may be plainly insubstantial either because it is obviously without merit or because its unsoundness so clearly results from the previous decisions of this Court as to foreclose the subject and leave no room for the inference that the question sought to be raised can be the subject of controversy.

The Weavers' claim, when filed, was a "substantial" claim within *Hagans* v. *Levine, supra,* for the following reasons: (1) there was, at best (from the Bank's point of view), a disparity of opinion between the various Courts as to whether a note or certificate of deposit is a security within the Federal Securities Act; (2) the Columbus agreement was unique; and (3) there was a lack of any prior Court decisions indicating that these instruments were not securities.

Once a federal court exercises jurisdiction to decide a case, as the District Court did in the present action in deciding this case on summary judgment, any dismissal which it renders is a dismissal on the merits and not a dismissal for lack of jurisdiction. *Bell* v. *Hood,* 327 U.S. 678 (1946). When the court exercises jurisdiction to decide the case on the merits, all of the closely related state law issues should be resolved by the federal court in one proceeding. *Rosado* v. *Wyman,* 397 U.S. 397, 404-5 (1970).

In Kavit v. *A.L. Stamm & Company,* 491 F.2d 1176 (2nd Cir. 1974), the Second Circuit affirmed the District Court's resolution of state law claims on the basis of pendent jurisdiction after the related federal securities claims had been dismissed prior to trial. Factors which the Second Circuit considered important included: (1) the substantial time period between the time the case was filed and the time a motion was submitted to dismiss the federal claim; (2) the amount of time that the parties had invested in the case; (3) whether the determination of the federal claim involved a significant federal issue; (4)

whether there would be a savings of substantial energy to the parties; and (5) whether it was convenient and fair to the litigants to resolve the state law claim in the federal forum. *Id.*, at 1180, footnote 4-5.

The exercise of pendent jurisdiction is discretionary. There was no indication in the District Court Opinion or upon the record that the District Court exercised any discretion in dismissing the Weavers' state claims. The District Court apparently concluded that once the underlying federal claim was dismissed, it not longer possessed jurisdiction to resolve the merits of the state court claims, even though *Bell* v. *Hood*, 327 U.S. 678 (1946), clearly holds to the contrary.

All the necessary pendent jurisdiction criteria set forth by the Court in *Kavit* v. *A.L. Stamm & Company, supra,* were met in this case. The District Court should have exercised its pendent jurisdiction over the Weavers' state law claims.[30]

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[30] The Bank filed its motion for summary judgment a few weeks prior to the scheduled jury trial. The Weavers had already invested two years preparing for a trial on all issues in federal court (i.e., May, 1979-December, 1980). The determination of the supporting federal securities claims and, specifically, the CD issue, involves a significant federal issue. Substantial judicial energy would be saved by resolving these claims in one forum. Considering the Weavers' advanced age and the backlog of civil cases in the Court of Common Pleas of Erie County, there is a substantial chance that any claim in that Court would not be resolved in the foreseeable future. Further, the Weavers instituted action in that Court against the Bank (at Civil Action Nos. 3308-A-1979 and 3325-A-1979) by way of a summons which was not served in reliance upon the federal court resolving the entire controversy. Any further prosecution of this claim in state court now may well be barred by a two year statute of limitation, 42 Pa.C.S.A. 5524, because the Bank was not served with the initial writ of summons.

In dismissing the claims premised on Pennsylvania law, the District Court relied upon *Lentino* v. *Fringe Employee Plans, Inc.*, 611 F.2d 474 (3rd Cir. 1979). There, however, the Court *affirmed* the District Court's exercise of pendent jurisdiction after the federal claim had been dismissed. The Court justified the exercise of pendent jurisdiction under those circumstances in "the interests of convenience and judicial economy," *Id.*, at 480.

Irrespective of what conclusion this Court makes as to the Columbus agreement or the CD being a security under the Federal Securities Acts, this Court should remand the case to the District Court — as opposed to dismissing it entirely — so that the District Court can resolve the Weavers' claims premised on Pennsylvania law.

The Third Circuit's decision that the District Court erred in dismissing the pendent state law claim is not before the Court because the Bank failed to raise this issue in its petition for certiorari. *Whirlpool Corp.* v. *Marshall*, 445 U.S. 1 (1980); Rule 23(c), Supreme Court Rules. Even if this Court would review the pendent jurisdiction issue, it should find that the Third Circuit Court of Appeals was correct in reversing the District Court and holding that the District Court had pendent jurisdiction over the Weavers' claim premised upon Pennsylvania law and that the circumstances of this case dictate that the District Court should exercise its jurisdiction to resolve these claims on their merits. *Rosado* v. *Wyman*, 397 U.S. 397 (1970); *Borror* v. *Sharon Steel Company*, 327 F.2d 165 (3rd Cir. 1964); and *United Mine Workers* v. *Gibbs*, 383 U.S. 715 (1966).

CONCLUSION

This Court should affirm the Order of The Third Circuit Court of Appeals reversing the grant of summary judgment in favor of the Bank. There were genuine is-

sues of material fact as to whether the Columbus profit sharing agreement with the Weavers was an "investment contract," a "profit sharing agreement" or a "certificate of interest" within the definition of a security under either the 1933 or 1934 Acts sufficient to preclude that issue from being resolved on summary judgment.

The additional holding that the Weavers' six year certificate of deposit was a security within these Acts should also be affirmed. The CD was literally within the definition of security and not excluded by any exemption. Its pledge in this secondary transaction involved investment-type risk to the Weavers made for the expectation of profits.

Irrespective of this Court's conclusion as to the Columbus agreement and the Weavers' certificate of deposit being securities, the Court should remand the case to the District Court so that the District Court can resolve the Weavers' claims against the Bank under Pennsylvania law in accordance with the Third Circuit's Opinion and Order that the District Court had pendent jurisdiction over these claims and should exercise that jurisdiction to resolve these claims on their merits. In addition to the controlling federal law on this issue, this result is warranted because of the Third Circuit's decision and because the pendent jurisdiction issue was neither challenged nor presented to this Court for review by the Bank.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK, *Petitioner,*

v.

SAMUEL WEAVER and ALICE WEAVER, *Respondents.*

On Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

AMERICAN BANKERS ASSOCIATION BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

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ISSUES PRESENTED FOR REVIEW

1. Whether an FDIC-insured deposit, evidenced by a certificate of deposit, bearing a fixed rate of interest should be deemed an investment for profit subject to the Securities Exchange Act or a commercial transaction subject to banking laws?

2. Whether a bank's alleged acts or omissions are in connection with an alleged sale of a security by a bank debtor to a third party for purposes of the Securities Exchange Act where the undisputed facts in the record show that the bank was not even aware of this alleged sale of a security?

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AMERICAN BANKERS ASSOCIATION BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

INTEREST OF THE AMICUS

The American Bankers Association is the largest national trade association of the commercial banking industry. Its membership is composed of approximately 13,250 banks, or over 90% of the industry. Among the very core functions of the industry are the making of business loans, often secured by a pledge of collateral, and the acceptance and repayment of various kinds of deposits. The industry is probably the most highly regulated of any industry in the United States; it is subject to a complex body of laws and is supervised by federal and state regulatory agencies which govern in great detail the performance of those core functions.

The Third Circuit's opinion in this case, if permitted to stand, will unnecessarily superimpose an entirely separate and

perhaps inconsistent regulatory scheme upon the already pervasive bank regulatory scheme. The American Bankers Association, on behalf of its members, appears here, with the consent of the parties, to show that Congress never intended such a result.

SUMMARY OF THE ARGUMENT

A commercial bank certificate of deposit is not a security, either under the plain words of the Securities Exchange Act of 1934 or when judged by the economic realities of that rather typical banking transaction. Moreover, a certificate of deposit is not sufficiently like the kinds of notes or bonds intended to be governed by the Securities Exchange Act, nor is it sufficiently like withdrawal capital shares of a savings and loan association for the securities laws to be applied to it. Indeed, application of the securities laws to a commercial bank certificate of deposit is unnecessary in view of the comprehensive regulatory scheme already in place for the protection of bank customers, and could well impose duplicative and inconsistent obligations on the banking industry.

The pledge of something that is not already a security does not make it a security. While a pledge may constitute a "sale" within the meaning of the Securities Exchange Act, that is only one of the statutory requirements. In order for the Act to apply, the thing sold must first be a security.

The involvement of the respondents in the business of a third party, unrelated to the petitioner bank, was a transaction separate and distinct, in law and in fact, from the certificate of deposit transaction. It was a transaction solely between the respondent and the third party, and entirely unknown to the petitioner bank. Regardless of whether that transaction constituted a sale of a security, nothing the petitioner bank did or failed to do was "in connection with" the sale of the security, because the record clearly demonstrates that the bank was unaware of the alleged sale.

ARGUMENT

I. BACKGROUND OF THE CASE.

In February, 1978, the respondents, Samuel and Alice Weaver, deposited $50,000 in the Marine Bank for a period of six years, at an interest rate of 7.5%,[1] and received a certificate attesting to this deposit. The object of the deposit was to have money available in a nearby bank for the operation of the Weavers' business. Joint Appendix at 62. The Marine Bank also had had prior dealings with a Mr. and Mrs. Raymond Piccirillo, doing business as the Columbus Packing Company. The Piccirillos were in need of additional financing for their business in order to pay off some outstanding indebtedness and to acquire working capital. Marine Bank agreed to extend a loan to the Piccirillos, provided that a guarantor could be found for the loan. Joint Appendix at 57.

Unbeknownst to the bank (Joint Appendix at 62, 64), in March, 1978, the Weavers and the Piccirillos entered into an agreement by whose terms the Weavers were to become "co-obligors" on the loan[2] and to receive in return a specified consideration. Joint Appendix at 11. The bank thereafter extended a loan to the Piccirillos in the amount of $65,000. The Weavers were not party to the loan transaction *per se*. Instead, they signed a separate document pledging their previously acquired certificate of deposit account as collateral for the Piccirillo loan.

When the loan was not repaid and Columbus Packing Company failed, the bank asserted its right to apply such part of the pledged certificate of deposit as might be needed to

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[1] The Third Circuit's opinion indicates that the interest rate was 6%, but that figure is erroneous. *See* Exhibit 1 to this brief.

[2] They never actually became co-obligors. That role was filled by the senior Piccirillos. The Weavers were guarantors instead. Thus, they became only secondarily liable on the loan, not jointly liable with the Piccirillos. Joint Appendix at 26, 34.

satisfy any deficiencies. The Weavers sued, ultimately alleging that both the certificate of deposit and the agreement with the Piccirillos were securities governed by the "anti-fraud provisions" of the Securities Act of 1933 and the Securities Exchange Act of 1934.[3] They further alleged that the bank had made material misrepresentations and had failed to reveal material facts in connection with the "sale" of the two "securities."

Summary judgment was granted to the bank in the U.S. District Court; the Third Circuit reversed, holding that both transactions could involve the sale of securities. This Court granted certiorari on June 1, 1981.

II. A COMMERCIAL BANK CERTIFICATE OF DEPOSIT IS NOT A SECURITY.

The Third Circuit did not hold that certificates of deposit *were* securities; instead the court held that they *could* be. The court allowed that "[p]erhaps at trial some distinguishing features may be developed." *Weaver* v. *Marine Bank*, 637 F.2d 157, 164 (3d Cir. 1981). But such a procedure is unnecessary. Whether a commercial bank certificate of deposit is a security is a matter of law, and not of fact. As a matter of law, a commercial bank certificate of deposit is not a security as we show in this section. Accordingly, the district court was quite correct in granting summary judgment.

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[3] The Third Circuit's decision never dealt with any issues surrounding the independent applicability of the 1933 Act, treating the case as though it arose only under the 1934 Act. For convenience we shall do so as well. *This* case ought to be decided the same way whether only the 1934 Act is applicable or both Acts are, although different cases may arise in the future in which the differences between the Acts may be important.

A. The Language Of The Statute.

Section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a) (1976)) provides that:

> When used in this chapter, unless the context otherwise requires. . .
>
> (10) the term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

"The *starting* point in every case involving the construction of a statute is the language itself."[4] A bank certificate of deposit is not specifically listed as a "security."

It is evident from the exhaustive list contained in section 3(a)(10) that Congress intended to include in the definition of "securities" every item that in the view of the legislators might be thought to be a security. Congress also added a catchall phrase to cover exotic or unusual transactions or anything that might be invented later that would have the same kind of characteristics or possibilities for abuse that the common and known securities had. H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). Yet certificates of deposit were a known and common part of the banking business at the time the original securities laws were passed in the 1930's; the banks had specific federal statutory authority to offer them since at least 1913. *See* §19 Federal Reserve Act, 38 Stat. 270.

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[4] *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979) (hereinafter "*Daniel*") (emphasis supplied).

Congress' failure to include a known commodity in the list of "securities" is indicative of its intent that commercial bank certificates of deposit not be considered securities.

This conclusion is supported by reference to what Congress *did* include among the enumerated securities: a "certificate of deposit, for a security." The statutory use of this term has reference to a type of receipt for something that is already a security. It is an instrument commonly used in corporate reorganizations. *See* 1 Loss, *Securities Regulation* 460-62 (2d ed. 1961). A bank certificate of deposit, on the other hand, has nothing to do with corporate reorganizations. It is simply an evidence of an unpaid balance of *money* or its equivalent, 12 U.S.C. §1813 (1976), and money is not a security.[5] In short, a bank certificate of deposit is nothing more than a savings device for its depositors.

In adopting the federal securities laws, not only did Congress fail to mention commercial bank certificates of deposit, but knowing that various forms of "certificate of deposit" existed, it chose only to include one of those forms within the statutory definition of security. Under commonly applied rules of statutory construction, the intent to exclude the other forms must be presumed.

The Fourth Circuit has so held in deciding specifically that a certificate of deposit was *not* a security. That court pointed out that the statutory reference to " 'certificate of

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[5] In other contexts, the Supreme Court has recognized that deposits in financial institutions, even those not payable on demand, retain the "quality of moneys." *Porter* v. *Aetna Casualty & Surety Co.*, 370 U.S. 159, 162 (1962). Thus, the Third Circuit was too quick to hold that "[t]he certificate of deposit pledged by the Weavers was certainly not currency." 637 F.2d at 164. In reality, the certificate — a piece of paper — was not what was pledged. Rather, the underlying account was pledged. That may not have been currency, but it certainly was the "functional equivalent" of currency. The Third Circuit ignored *this* "functional equivalence" although it stood ready to hold the bank liable for dealing in something that is not a note or a bond, but is (in the court's opinion) the "functional equivalent" of a note or a bond.

deposit, for a security' has a negative pregnant: impliedly it excludes a certificate of deposit issued for currency or payable in currency." *Burrus, Cootes & Burrus* v. *MacKeithan,* 537 F.2d 1262, 1265, *vacated as moot,* 545 F.2d 1388 (4th Cir. 1976); *cert. denied,* 434 U.S. 826 (1977). *See also Canadian Imperial Bank of Commerce* v. *Fingland,* 615 F.2d 465, 468 (7th Cir. 1980).

In any event, the Third Circuit correctly held that the term "certificate of deposit, for a security," appearing in the statutory definition of "security" did not mean the same thing as a commercial bank certificate of deposit. *Weaver* v. *Marine Bank, supra,* 637 F.2d at 164 (fn. 9). The court was also correct in deciding, by inference at least, that most of the other forms of "security," such as stock, and oil and gas royalties, did not apply here.

The only two terms in section 3(a)(10) upon which the Third Circuit sought to rely in order to find that a commercial bank certificate of deposit might be a security were the words "note" and "bond." The court did not hold that a certificate of deposit *is* a note or a bond, but rather that it is or may be "functionally equivalent" to one or the other,[6] given the "economic realities" of the transaction. The court also found sufficient similarities between commercial bank certificates of deposit and the kind of withdrawable capital shares of a savings and loan association held to be a security by this Court in *Tcherepnin* v. *Knight,* 389 U.S. 332 (1967) (hereinafter "*Tcherepnin*"). Both characterizations are erroneous as we show below.

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[6] In dealing with the economic realities of the transaction involved here, we do not distinguish between "notes" and "bonds." A bond is simply a special kind of note. *See* Munn, *Encyclopedia of Banking & Finance* 132 (1973). The technical distinctions between bonds and other notes are not relevant when the concentration is upon economic realities, as it must be.

B. Certificates Of Deposit And "Economic Realities."

In determining whether a particular transaction is one involving a "security" within the meaning of the Securities Exchange Act, it is not sufficient to show that the transaction does or does not fall within the enumerated categories of security set forth in the Act, although, as indicated above, that is the starting point. This Court has cautioned that "form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin*, *supra*, 389 U.S. at 336. The "economic realities" approach to deciding such issues has the effect of including certain transactions which would not seem to be covered by mere reference to the words of the Act,[7] and excluding others which would seem to be specifically covered by the words of the Act.[8]

The test for evaluating the "economic realities" of a transaction has been set forth by this Court. In *SEC* v. *Howey*, 328 U.S. 293, 301 (1946) (hereinafter "*Howey*"), the Court dealt with the analysis of the term "investment contract" — one of the categories of "security" included in the definition found in the 1934 Act. The Court held that the basic test for distinguishing investment contracts from other commercial dealings is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, *supra*, 328 U.S. at 301.

In *Forman*, the Court expanded on *Howey* so that the "investment contract" analysis is now to be applied in any determination of what is or is not a security:

> This test, in shorthand form, embodies the essential attributes that run through *all* of the Court's decisions

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[7] *E.g.*, *Tcherepnin*, holding that withdrawable capital shares of a savings and loan association are securities, although no reference is made to savings and loan shares in the statutory definition.

[8] *E.g.*, *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 848 (1975) (hereinafter "*Forman*"), holding that stock in a housing cooperative was not a security even though the statute specifically provides that "security" includes "any . . . stock."

> defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. *By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, . . . or a participation in earnings resulting from the use of investors' funds.*

Supra, 421 U.S. at 852 (emphasis supplied).

1. "Notes"

In lower court cases involving "notes," the majority have followed — and in some instances have anticipated — the Supreme Court's direction and have applied the investment contract analysis to determine which "notes" are governed by the Securities Exchange Act and which are not because the context requires otherwise. Generally, these cases find a distinction between "investment notes" intended to be covered by the securities laws and "commercial notes" which are not.[9]

The common thread running through all of these cases establishing or following the "commercial/investment" distinction is a search for the fundamental element of *profit* in the transaction, and it is profit as the Supreme Court has defined that term. "Profit" is not synonymous simply with "earnings" or a return on funds or anything of the sort. It is limited to a return based upon the entrepreneurial and managerial efforts of others. In cases where such a "profit" moti-

[9] *See Bellah* v. *First National Bank of Hereford, Texas*, 495 F.2d 1109 (5th Cir. 1974); *National Bank of Commerce of Dallas* v. *All American Assurance Co.*, 583 F.2d 1295 (5th Cir. 1978); *Emisco Industries, Inc.* v. *Pro's, Inc.*, 543 F.2d 38 (7th Cir. 1976); *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354 (7th Cir. 1974), *cert. denied*, 423 U.S. 825 (1975); *Canadian Imperial Bank of Commerce* v. *Fingland, supra*, 615 F.2d; *Burrus, Cootes & Burrus* v. *MacKeithan, supra*, 537 F.2d; *Union Planters National Bank of Memphis* v. *Commercial Credit Business Loans, Inc.*, _____ F.2d _____ (6th Cir. 1981) [1981 Transfer Binder] *Federal Securities Law Reports* (CCH) ¶ 97,996; and *Lino* v. *City Investing Co.*, 487 F.2d 689 (3d Cir. 1973).

vation can be found, the transaction is held to be a security; where it cannot be found, the transaction is held not to be a security. Even where there may be a mix of "profit" and other forms of earnings, the dominant factor is determinative. In *Daniel*, for example, this Court found that *some* of the pension benefits ultimately to be received by a retiree would be derived from the "managerial efforts" of the Plan's trustees, but the Court still declined to hold that the pension plan was a security since most of the Plan's income was in the form of employer contributions and only a small portion came from investment of assets. *Daniel, supra*, 439 U.S. at 562.

Thus, when the Weavers in this case deposited $50,000 in the Marine Bank, they did not have any intention of making a *profit* on those funds.[10] Instead, the intention of the Weavers was to earn *interest* on their funds. Their rate of return was a fixed one — 7.5% — and receipt of that specified interest did not depend one whit upon the managerial or entrepreneurial efforts of the bank. If the bank made a profit in excess of 7.5%, the Weavers would not be entitled to share in that profit. They would still receive only 7.5%. By the same token, if the bank has a profit smaller than 7.5%, or if it suffered a loss in its operations, that would not reduce the Weavers' entitlement. They would still receive the agreed-upon 7.5%. Here, when the Weavers deposited their money in the bank, they entered into a purely commercial transaction; in essence, lending money to the Bank. Under the terms of the certificate itself (Exhibit I), they were entitled to a return of the money "lent" to the bank at maturity in February, 1984, together with an agreed-upon interest rate.[11] No element of an investment transaction appears, so the certificate of deposit cannot be a security.

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[10] In fact regulations of the Federal Reserve and the Federal Deposit Insurance Corporation specifically prohibit the use of the term "profit" in referring to interest earned on deposits. 12 C.F.R. §§217.6(f) (1980) and 329.8(e) (1981).

[11] What the Weavers did with the certificate of deposit later is not relevant to the determination of whether it was a security at the outset, as we shall discuss below. Here we deal solely with the deposit relationship between the Weavers and the bank.

A consideration related to an expectation of profit from the efforts of others is the *risk* of loss of most or all of the investment. Where such a risk does not exist, the transaction is normally not classified as a security. The consideration of an element of risk in the determination of what is and what is not a security is consistent with one of the overriding purposes of the securities laws.

The purpose of the Securities Acts is perhaps best set forth in President Roosevelt's March 29, 1933 message to Congress proposing that such laws be enacted:

> I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce . . .
>
> Of course, the Federal Government cannot and should not take any action which might be construed as approving or *guaranteeing* that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.
>
> There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

S. Rep. No. 47, 73d Cong., 1st Sess. 6-7 (1933) (emphasis supplied).[12]

When Congress followed the President's recommendation, it was not interested in enacting a law governing those transactions in which there was some guarantee; only for those transactions in which loss of all or most of the investment was possible. The object of the Securities Act was not to eliminate risk in securities transactions, but rather to make the risk an informed one. Even in the case of corporate bonds, which have a fixed rate of return regardless of the "profit" of

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[12] The President's message immediately preceded passage of the Securities Act of 1933, whereas this case arises principally under the provisions of the Securities Exchange Act of 1934. Nonetheless, to the extent that the antifraud provisions of the 1934 Act are designed to assure full disclosure of material facts to investors, its purpose is certainly the same as that of the 1933 Act.

the corporation, there is often a significant element of risk. The corporation may default on the bonds due to insolvency. Consequently, the securities laws expressly include such bonds. When Congress enacted the Securities Exchange Act it recognized only what was common understanding: "investment," in the mind of the investor, is a trade-off — a willingness to accept a risk of loss in return for the hope of a higher return than could be achieved by other, safer uses of the money, such as putting it in a bank.[13]

Precisely because of the absence of risk, the Ninth Circuit, in a case dealing with a credit line extended by a bank to a corporation evidenced by a note, declined to hold that the note was a security within the meaning of the Securities Acts:

> GWB [the bank] left very little to chance. Artko [the corporation] could do little without answering to bank. . . . While some "risk" was created by the lending of money, it amounted only to that risk normally associated with the lending of money for a period of time. There was no substantial dependent relationship between GWB's risk and Artko's enterprise efforts.

Great Western Bank & Trust v. *Kotz*, 532 F.2d 1252, 1259-60 (9th Cir. 1976) (footnotes omitted).

In *Forman*, *supra*, 421 U.S., while this Court declined to abandon the "profits" test and adopt a "risk capital" approach to the definition of securities, Justice Powell's majority opinion pointed out that application of such a test in that case would have achieved the same result:

> Purchasers of apartments in Co-op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. . . . In view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility. In any event, the risk of insolvency of an ongoing housing cooperative "differ[s] vastly" from the kind of risk of "fluc-

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[13] Congress *did* intend to guarantee the safety of bank deposits in separate, though contemporaneous, legislation creating the Federal Deposit Insurance Corporation. 48 Stat. 168 (June 16, 1933).

tuating" value associated with securities investments.

Id. at 857, n. 24. (citation omitted).

In the case of a certificate of deposit issued by a commercial bank, there is no risk to the depositor. The depositor may recover the initial deposit in full; there is not the kind of fluctuating value associated with securities; and the careful regulation of commercial bank operations by the state and federal government[14] makes any kind of failure to repay the deposit by the bank an unrealistic possibility.

2. "Withdrawable capital shares"

In addition to relying upon the words "note" and "bond" in the statute, the Third Circuit has relied also upon this Court's opinion in *Tcherepnin*, reasoning that since the withdrawable capital shares of a savings and loan association in that case were securities, and since the certificate of deposit here in issue was virtually indistinguishable from the savings and loan shares, at least in the mind of the "investor," then the certificate of deposit must be a security too. That reliance is misplaced, since every single characteristic of the transaction in *Tcherepnin* which this Court found to be of controlling importance is missing in this case. Indeed, a comparison of the two cases shows that the profit and risk analysis we suggest is the correct one.

In the *Tcherepnin* case, the "security" involved was a withdrawable capital share of an Illinois state-chartered savings and loan association. The character of these shares was determined by Illinois law. 389 U.S. at 336. Under that statute, the holders of the shares each became members of the savings and loan association and entitled to vote on association matters, much like stockholders in other business corporations are entitled to vote on corporate matters. 389 U.S. at 337. In the case of the Weavers here, holding the Marine Bank's certificate of deposit gave them no such right to vote

[14] *See* discussion below, pp. 16-21.

on corporate matters of the bank. They were not "members" of the bank; they were customers or depositors only.[13]

In *Tcherepnin*, the holders of the shares of the savings and loan association were not entitled to a fixed rate of return, but were entitled to receive instead whatever dividends might be declared from time to time by the board of directors. 389 U.S. at 337. Once again, the arrangement was much like the typical business corporation which pays its stockholders whatever dividends its directors establish, and which may vary periodically. This is not the case with respect to the Weavers' certificate of deposit. They contracted for a fixed rate of return, for a fixed period of time and the bank was contractually obligated to pay that rate of return, no more, no less, regardless of whether interest rates generally went up or down during the period the certificate was in force, and regardless of anything the bank's board of directors might have preferred after the fact.

In *Tcherepnin,* the return the investors received on their funds was tied, by law, to an apportionment of profits, and thus depended upon the skill and honesty of the managers of the savings and loan. The more profitable the operation of the business, the larger the dividend; if the profit was small or non-existent in any particular year, the dividends likewise diminished or disappeared. Not so in the case of the Weavers here. It mattered not whether Marine Bank suffered major losses in the conduct of its business or had the most profitable year any bank ever had; its obligations to the Weavers were fixed — 7.5% interest on $50,000 for six years.

In *Tcherepnin*, the savings and loan association was uninsured, so shareholders stood to lose any money they had in the association in the event of insolvency. In this case, the

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[13] The Third Circuit's opinion, 637 F.2d at 164, states that "bank securities are not exempt from the antifraud provisions of the 1934 Act." That is correct as far as it goes, but what is obviously meant by that is the capital stock of a bank — the kind of equity interest in a bank that was acquired by shareholders in the *Tcherepnin* case, but is *not* acquired by deposit holders like the Weavers.

deposits in Marine Bank were and are insured by the Federal Deposit Insurance Corporation, so even if the bank were to become insolvent, depositors (including holders of certificate accounts) would substantially recover their funds.

Even the legislative history is different as it applies to the shares in *Tcherepnin* and the certificate of deposit here. As this Court pointed out in *Tcherepnin*, there was testimony in 1933 before the House Committee on Interstate and Foreign Commerce by the United States Building and Loan League evidencing the understanding that the securities laws would apply to savings and loan shares. The League requested an exemption from the registration requirements of the law (which was granted), but specifically disclaimed any interest in an exemption from the anti-fraud provisions. *Tcherepnin*, 389 U.S. 340-42. The contrary conclusion must be drawn from the legislative history with respect to commercial bank deposits. The very same hearings show an understanding on the part of Congress that only the capital stock of commercial banks would be considered to be securities, and those securities would also be exempt from the registration requirements of the law:

> Mr. Mapes: This section exempts securities of national banks from coming under the provisions of the law. What securities do you have in mind there — anything except the stock of national banks?
>
> Mr. Thompson: It would be any kind of a security of a national bank. I do not suppose a national bank would be putting out anything in addition to its capital stock.
>
> Mr. Mapes: What would that be?
>
> Mr. Thompson: It is only stock, so I am told.

Hearings on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 31 (1933) (testimony of Huston Thompson).

Mr. Thompson was one of the drafters of the bill which eventually became the Securities Act of 1933. *See id.* at 9. He could think of no "securities" of national banks other than capital stock, even though commercial banks had had the explicit statutory authority to offer certificates of deposit to

their customers since at least 1913 (Federal Reserve Act §19, 38 Stat. 270 (Dec. 23, 1913)).

C. Certificates Of Deposit And The Bank Regulatory Scheme.

Aside from the "economic realities" discussed above, there is another kind of reality, recognized by this Court, which is important to the determination of whether the securities laws are applicable to a particular transaction. That is the existence of a comprehensive regulatory scheme directed at the specific transaction or instrumentality independent of the securities laws.

Banking is subject to some of the most complex and comprehensive statutory and regulatory schemes devised by both the federal and state governments. *Cook County National Bank* v. *United States*, 107 U.S. 445, 448 (1883); Davis, *Administrative Law* §4.04 at 247 (1st ed. 1958). There can be little doubt that much of this legislation has been designed to, and in fact does, protect not only the banking system itself, but also especially bank depositors. Some portion of the federal regulatory structure — for instance, the rules concerning advertising in connection with deposits (and certificates of deposit) — protect depositors in banks in much the same way that the Securities Acts protect investors in securities.

Yet despite this complete and detailed bank regulatory scheme, the Third Circuit concluded that there is no presumption that Congress intended to exclude banks from the protection of section 10(b) of the Securities Act of 1934. *Weaver, supra,* 637 F.2d at 163.

This conclusion ignores the *Daniels* case, *supra*, wherein this Court held that when comprehensive *federal* legislation governs an entire subject area, "all arguments for extending the Securities Acts" to that area are "severely undercut." 439 U.S. at 569. It also ignores decisions of this Court which hold that there is a presumption against extending the federal securities laws to areas which are governed by *state* law. *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977). A presumption

against application of the securities laws to the banking industry ought to be even stronger since there is already a complementary two-tier system, with *both* federal and state laws offering depositor protection.

1. State laws protecting bank deposits and depositors

Marine Bank is chartered by the Commonwealth of Pennsylvania and is subject to Pennsylvania banking laws.[16] Pennsylvania regulates many functions of banking, including the important deposit-taking function. Marine Bank's power to receive deposits is granted in section 302. The requirement that it give a "receipt" for every deposit (*e.g.*, a certificate of deposit) is specified in section 602(a). Section 105 requires Marine Bank to insure its deposits with the FDIC. Even aside from this important insurance, however, Pennsylvania, like all other states, has a host of laws geared to assuring the soundness of bank deposits.

One such law requires banks, such as Marine, which are not members of the Federal Reserve System, to maintain fixed reserves on time deposits (section 703), including funds represented by certificates of deposit. Although reserves serve a growing number of purposes, historically one of their principal benefits has been to assure a sufficiently liquid asset structure to meet the demand of depositors. Reserve requirements have been imposed on Pennsylvania banks since at least 1907, and the present law is very specific in setting forth the kinds of deposits which will qualify as reserves. Only coin, currency, U.S. obligations, and other marketable obligations specifically approved by the Department of Banking will do. (Section 704). Banks do not take reserve requirements lightly. They must give notice to the state regulator of any deficiency in their reserve fund within three days of the deficiency or they are subject to penalty. (Section 705).

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[16] Most of the laws are collected in Title 7, *Pa. Stat. Ann.* (Purdon 1967 and Supp. 1981) Unless otherwise indicated, the section references which follow are to that title.

Many other state laws are geared to preserving the soundness of banks which benefit depositors as well as shareholders and the public. For instance, in Pennsylvania, banks are limited in the size of loans they may make to a single borrower (section 306); in the rates of interest they may charge on different classes of loans (*see, e.g.*, sections 316-18, *Pa. Stat. Ann.* tit. 41, §201, *Pa. Stat. Ann.* tit. 69, §1904 (Purdon Supp. 1981); *see also* federal law 12 U.S.C.A. §86a (West. Supp. 1981)). They are regulated in branching, (sections 904 *et seq.*); in mergers and consolidations, (section 1601); in acquisitions, (section 112); and in forming a bank holding company, (sections 6001 *et seq.*).

Moreover, most states require frequent bank examinations, which allow for the continuing review of the polices and practices of commercial banks. While Pennsylvania authorities may, and do, accept FDIC examinations in lieu of their own, the law grants them the concurrent power to examine banks "at any time it deems such action necessary or desirable *for protection of depositors*, other creditors, or shareholders." (Section 2002) (emphasis supplied).

In addition to state statutes specifically pertaining to commercial banks, the respondents in this case assert that they have "a cause of action against Marine Bank under the [Pennsylvania] common law of fraud and misrepresentation." Complaint, ¶ 35, Joint Appendix at 9. If that is so — and we offer no opinion on the subject — then it is clear that it is unnecessary for the federal courts to assert jurisdiction under the federal securities laws.

2. Federal laws protecting bank deposits and depositors

The most significant protection for bank depositors is, of course, the federal deposit insurance fund which is administered by the FDIC.

Before a bank obtains federal deposit insurance, the FDIC must consider the adequacy of the bank's capital structure, the financial history of the bank, its future earnings prospects, the general character of its management, and the con-

venience and needs of the community to be served. 12 U.S.C. §1816 (1976). This assures that a bank begins on a sound basis.

Periodic examinations by the FDIC assure continuing protection for depositors and others. These examinations occur at least every 18 to 24 months and are conducted in accordance with uniform principles and standards for examinations prescribed most recently by the Financial Institutions Examination Council established by the Financial Institutions Regulatory & Interest Rate Control Act of 1978. 12 U.S.C. §3305(a) (Supp. III 1979).

At the time the Weavers' deposit was made, it was insured by the FDIC to $40,000,[17] and, therefore, theoretically some portion of the deposit was at risk. As this Court suggests in *Forman, supra,* 421 U.S. at 857, n. 24, however, lack of a 100 percent guarantee is not fatal in testing the applicability of the securities laws. And, as the Court said in *Daniel*, it is not proper to bring within the ambit of securities laws something that otherwise would not be there by focusing on the less important aspects of the transaction. 439 U.S. at 561. That the deposit was predominantly insured is enough.

Moreover, bank safety is not totally dependent on federal insurance. There are many controls placed on banks by Congress which assure the integrity of banks and the safety of their deposits even in addition to the deposit insurance *per se*. For example, no insured bank can reduce its capital stock without consent of the FDIC[18] (12 U.S.C. §1828(c) (1976)); all insured banks must report any changes in voting stock that will result in an acquisition or a change in control in a bank (12 U.S.C. §1817(j) (1976)); banks must obtain FDIC ap-

[17] The insurance ceiling was increased to $100,000 by a 1980 amendment to the FDIC Act. Act of March 31, 1980, Pub. L. No. 96-221, 94 Stat. 147, §308(b)(1).

[18] We deal here only with laws administered by the FDIC, since Marine Bank is a state bank subject to FDIC's jurisdiction. There are, however, comparable laws administered by the Comptroller of the Currency and the Federal Reserve Board applicable to banks under their respective jurisdictions.

proval to participate in mergers or to branch (12 U.S.C. §1828(c) and (d) (1976)); they are limited in forming a subsidiary corporation to do data processing (12 U.S.C. §§1861 and 1865 (1976)) and in forming a bank holding company (12 U.S.C. §1842 (1976)).

Banks are required to submit quarterly reports of condition to the FDIC (12 U.S.C. §1817(a)(4) and (5) (1976)). They must follow criteria established under the Bank Protection Act of 1968 to secure the bank's premises. (12 U.S.C. §§1729, 1881-84 (1976)). FDIC also requires banks to maintain blanket bonds (geared to the size of the bank) to cover losses occasioned through dishonest employees, fraud, burglary, forgery, misrepresentation, etc. (12 U.S.C. §1828(e) (1976) and FDIC Manual of Examination Policies §O).

The FDIC also has at its command a plethora of disciplinary powers which it may exercise to protect depositors. It can suspend or remove bank officers and directors for violations of the law or for previous dishonesty (12 U.S.C. §1818(e) (1976)), and it can order a bank to "cease and desist" in engaging in unsafe and unsound bank practices (12 U.S.C. §1818(b) (1976)). One action or inaction considered unsafe or unsound is "operating with management whose policies and practices are detrimental to the bank and *jeopardize the safety of the bank's depositors.*" (1979 FDIC Manual of Examination Policies §V) (emphasis supplied).

3. Specific regulations governing certificates of deposit accounts adequately protect depositors.

The application of the antifraud provisions of the securities laws to commercial bank certificates of deposit would most certainly be a case of regulatory overkill. The advertising regulations by which FDIC-insured banks, like Marine Bank, must abide already provide a form of disclosure to depositors which accomplishes as much or more in that regard as do the disclosure requirements of the securities laws for transactions in securities. Advertisements of interest on such deposits must conform to rules assuring adequate disclosure to prevent un-

fairness or deception. 12 C.F.R. §329.8 (1981). Advertisements, announcements or solicitations relating to interest paid on deposits may not be inaccurate or misleading or misrepresent the deposit contract. 12 C.F.R. §329.8(f) (1981). Persons who solicit certificates of deposit for banks are also bound not to mislead or misrepresent or to engage in unfair or deceptive disclosures. 12 C.F.R. §329.8(g) (1981). If banks offer certificates of deposit and advertise certain rates on the deposits which contain either time or amount limitations, these limitations must be clearly and conspicuously stated. 12 C.F.R. §329.8(d) (1981). These regulations carry their own sanctions as well. The FDIC is authorized to impose on any offending bank a civil penalty of up to $100 per day for violations. 12 U.S.C. §1828(h) (1976).

As a result of these many, varied, comprehensive statutes and regulations, it is clear that Congress intended to protect bank depositors by means of the banking laws without adding an additional layer of regulation and regulators under the securities laws. Therefore, simply "presuming" coverage by the securities laws, in the absence of some indication of Congressional intent, as the Third Circuit did in this case, creates the very great risk of needlessly duplicative and potentially conflicting obligations on the part of banks, and, as this Court said, "it serves no general purpose." *Daniel,* 439 U.S. at 570.

D. A Certificate Of Deposit Is Not Transformed Into A Security When It Is Pledged.

In preceding sections of this brief, we have considered the relationship between a bank and its customer when the customer *places* funds on deposit in the bank and receives a certificate of deposit as a receipt for it. The discussion above shows that this transaction is not a securities transaction, nor would a securities transaction be involved in a case where the depositor simply *withdrew* the funds on deposit for any reason or no reason at all. To the contrary, such deposits and withdrawals are simply routine banking transactions, not governed by the Securities Exchange Act of 1934.

What is alleged to make this case different is the fact that the Weavers *pledged* their deposit as collateral for a loan to the Piccirillos and received an agreed upon consideration from the Piccirillos for this service. This Court has held that a pledge constitutes a "sale" within the meaning of the securities laws. *United States* v. *Rubin*, 66 L. Ed. 2d 633 (1981). Nonetheless, the "sale" is only one of the necessary elements of a securities law violation. In order to bring the securities laws into play, not only must there be a "sale," but the thing "sold" must also *be* a security to begin with. The Third Circuit agreed, carefully holding that the bank's alleged acts or practices were actionable "unless the pledge arrangement was not a sale *or* the certificate of deposit is not a security." 637 F.2d at 163 (emphasis supplied). In *Rubin* there was a pledge of *securities*, and thus there was a potential liability under the securities laws; here there was a pledge of a non-security, and the law does not apply to that.

III. THE BANK DID NOT ACT OR FAIL TO ACT "IN CONNECTION WITH" THE WEAVER/PICCIRILLO AGREEMENT.

The pledge of the funds represented by the certificate of deposit and the Weaver/Piccirillo agreement are distinct and separable transactions, and all parties to this action are in agreement on this point. The Weavers argue:

> 1. That there was the purchase and sale of a security by Weaver to Marine Bank and specifically, a sale of a $50,000 certificate of deposit to Marine Bank on March 17, 1978.
>
> 2. That they purchased a *second* security on March 17, 1978 "in connection with" the transaction made reference to in the above paragraph of this answer.

Plaintiffs' Answer to Defendant's Motion for Summary Judgment, Joint Appendix at 39 (emphasis supplied).

The "second security" alleged was, of course, the Weaver/Piccirillo agreement, which was the entire subject of the original complaint. *See* Joint Appendix at 4-9.

The Third Circuit also dealt separately with the two transactions. It held that (1) the Weaver/Piccirillo transaction, independent of anything else, could be the purchase and sale of an investment contract, 637 F.2d at 161-62; and (2) that the pledge of

the certificate of deposit, independent of anything else, could constitute the purchase and sale of the functional equivalent of a note or a bond, 637 F.2d at 163-64.

Consequently, there is not here involved a singular transaction which, taking together its component parts, can be described as a "security" transaction. Each part must be considered on its own merits. We have shown above that the certificate of deposit account was not a security at the time the deposit was made, and that the subsequent pledge of the deposit did not make it so. In this section we will show that the separate transaction, the contract between the Weavers and the Piccirillos, does not give rise to liability on the part of the bank however that agreement is characterized.

Even if the Weaver/Piccirillo transaction is held to be the sale of a security (a subject this *amicus* does not choose to address), that is a matter between those parties only and, under the circumstances here, does not involve the bank.

Section 10(b) of the Securities Exchange Act prohibits fraud, misrepresentation and failure to reveal material facts, but only when done *in connection with* the sale of a security. The Third Circuit held that a fact finder could find on the record that the bank's activities were in connection with the Weaver/Piccirillo agreement. It then went on at length to discuss whether that agreement was a security, but did not stop to analyze the very important words "in connection with." On the record a fact finder could *not* have found that "connection" because the bank was wholly unaware of the existence of the agreement. The affidavits of the only two bank employees who had any involvement in the transaction establish that they did not know of the contract (Joint Appendix at 20, 22), and Mr. and Mrs. Weavers' depositions (Joint Appendix at 62-63, 64) confirm that the bank had no knowledge of the contract. The contract was signed in the Weavers' home, with only the Weavers and the Piccirillos present, and on the same day that the loan and pledge transaction took place.

As far as the bank knew, or could have known, the pledge of the certificate of deposit as collateral for the loan could have been entirely gratuitous (Joint Appendix at 49), or it could have been for some consideration paid to the Weavers *not* constituting a

security. For example, the Piccirillos could have made a cash payment to the Weavers at the time; the consideration could have involved only the use of the Piccirillos' barn and pastures, a promise by the Piccirillos to direct customers to the Weavers' auction business (Joint Appendix at 49), or any number of other forms of consideration which no one would contend to be securities under any definition.

The lack of knowledge on the part of the bank demonstrates that the plaintiffs have failed to satisfy the fundamental "in connection with" element of a securities violation.

To begin, the words "in connection with" and the reference to *material* facts in the statute and in Rule 10b-5 connote a *causal* relationship between the alleged violation and the alleged purchase or sale of a security, and this Court has so held. In *Affiliated Ute Citizens of Utah* v. *United States,* 406 U.S. 128, 154 (1972), Justice Blackmun wrote for the Court that: "This obligation to disclose and this withholding of a material fact establish the *requisite element of causation in fact.*" (emphasis supplied).

In *Superintendant of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 12-13 (1971), Justice Douglas' opinion for the Court pointed out that the victim of the securities law violation had "suffered an injury *as a result of* deceptive practices touching its sale of securities as an investor." (emphasis supplied)

"Causation" is a doctrine imported into securities law cases from pre-existing common law torts. In fact, the "causation" element of the securities laws "is determined to be the statutory equivalent of the element of tort causation." *Imperial Supply Co., Inc.* v. *Northern Ohio Bank,* 430 F. Supp. 339, 361 (N.D. Ohio 1976).

Professor Loss says that "[s]tatutes build on the common law and, especially when statutes are new, judges and lawyers who are trained in common law are apt to look to it for guidance." 3 Loss, *Securities Regulation,* 1430 (2d ed. 1961). Dean Ruder agrees, pointing out that "tort theory has been a fertile source of doctrine under Rule 10b-5 and other securities laws" and particularly "tort law dealing with deceit." Ruder, "Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution," 120 U. Pa. L. Rev. 597, 620, 612 (1972).

Tort law principles of "causation," in turn, incorporate the element of foreseeability, even with respect to fraudulent misrepresentation:

> One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance *in the type of transaction in which he intends or has reason to expect their conduct to be influenced.*

Restatement (Second) Of The Law, Torts §531 (1977) (emphasis supplied).

The lower courts have adopted the foreseeability element in construing the term "in connection with" in other securities law cases, generally following the well-regarded opinion of the Second Circuit in *Securities & Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968), *cert. denied sub nom., Coates* v. *Securities & Exchange Commission*, 394 U.S. 976 (1969):

> Rule 10b-5 is violated whenever assertions are made . . . in a manner reasonably *calculated* to influence the *investing* public.[19] (emphasis supplied).

In *Texas Gulf Sulphur*, the corporation was issuing press releases that it knew would influence the decisions of thousands of purchasers and sellers of its own securities on a national securities exchange. By contrast, in this case the bank could hardly have calculated to influence an *investor* where it admittedly did not even know that the Weavers were to be *investors*. Even assuming an active role by the bank in this case, the worst that can be said is that the bank's efforts were "calculated" to influence the Weavers to participate in the making of a bank loan, and that is not a security.

In *Wessel* v. *Buhler*, 437 F.2d 279, 282 (9th Cir. 1971), allegedly misleading statements in a corporate financial report

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[19] The word "calculated" is like the words "manipulative or deceptive" and "device or contrivance." This Court has held that these latter words "strongly suggest that §10(b) was intended to proscribe *knowing* or *intentional* misconduct." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976) (emphasis supplied). The Court cited the *Texas Gulf Sulphur* case in support of that holding.

did not lead to liability for the accountant preparing the statements for the same reason. The statements were not made "in connection with" the purchase or sale of securities, even though securities ultimately were sold, because the accountant did not know that the statements would be used in preparing prospectuses which, in turn, would be used in the sale of securities.

In *Landy* v. *Federal Deposit Insurance Corporation*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974), the court found that where accountants made certain allegedly false representations in a report of the bank's financial condition to its directors, such representations were not reasonably calculated to influence the investing public, and the accountants simply had no reason to foresee that their statements would be so used.

In *Sharp* v. *Coopers & Lybrand*, 457 F. Supp. 879, 887 (E.D. Pa. 1978),[20] the court specifically held that

> the "in connection with" requirement of Rule 10b-5 imposes in these cases the limitation that defendants can be liable for misrepresentations and omissions only if the defendants reasonably could foresee that these misstatements would be used in connection with the purchase or sale of a security.[21] (footnotes omitted).

Finally, Jennings and Marsh discuss the liability of accountants for fraud or misrepresentation in connection with the purchase or sale of securities as follows:

> If the certified financial statements or opinions are *intended to be used and are used, to the knowledge of the accountants,* in the sale of securities by the company or

[20] Affirmed in part, reversed in part on other grounds, _____ F.2d _____ (3d Cir. 1981), [1981 Transfer Binder] *Federal Securities Law Reports* (CCH) ¶ 97,971. The Third Circuit's opinion in this case did not specifically address the "in connection with" aspect of the district court's opinion quoted here. It did hold, however, that an accounting firm has a high standard of care in supervising its employees' preparation of documents which it knows will be used to influence investment decisions.

[21] The court distinguished between foreseeability of the *transaction*, discussed in this quotation, and foreseeability of *damages*, a separate issue. If the *transaction* is not foreseeable, as is the case here, then the actions or inaction of the defendant are not "in connection with" the purchase or sale of the security.

> someone else to the public, there would seem to be little question that the purchasers are persons entitled to complaint of that breach of duty.

R. Jennings & H. Marsh, *Securities Regulations: Cases and Materials* 1132 (4th ed. 1977) (emphasis supplied).

While this Court has not yet had occasion to determine whether knowing participation in a securities transaction is necessary to satisfy the "in connection with" requirement in section 10(b), it has determined that knowledge of the errors or omissions in statements of material facts, and an intent to make such errors or omissions, is essential to this class of claims. The reasons the Court adopted the scienter requirement in *Ernst & Ernst, supra,* 425 U.S., are equally compelling here.

As a normal part of their everyday business, commercial banks extend loans, both personal and commercial, and accept pledges from third parties as collateral. The collateral pledged may be virtually anything from the kind of certificates of deposit involved here to real estate to personalty. In the vast majority of such loan transactions, federal securities laws are in no way involved. But what the Third Circuit did in this case was impose what amounts to strict liability on a defendant who was admittedly unaware that the transaction (which was arguably one of the rare ones bringing the securities laws into play) was even occurring. Where Congress has intended to impose strict liability for securities transactions, it has done so quite clearly. For example, if an untrue statement of material fact is made in a registration statement, any person acquiring the registered securities can sue the issuer of such securities without regard to the knowledge or intent of the issuer. 15 U.S.C. §77k(a) (1976). Such clarity of congressional purpose is not evident with respect to section 10(b) as this Court held in *Ernst & Ernst, supra,* 425 U.S. at 200-01.

The logical and inevitable consequences of imposing strict liability on a bank, where it does not even know that a securities transaction is involved, point out the absurdity of so holding. If a bank is liable for unknown securities violations, it would seem that in *every* loan-and-pledge transaction in the future a bank would have some obligation — if only for its own protection — to inquire what, if anything, the pledgor is to receive as consideration for making the pledge. That infor-

mation would not ordinarily be sought since it does not in any way relate to the adequacy of the collateral for the loan. Then the bank must determine whether or not that consideration constitutes a "security." That may be a difficult task, as in this case, and again, that kind of determination does not normally arise in commercial banking activities. Next, if it *is* found or thought to be a security, the bank must disclose to the pledgor all material facts known about the borrower and thus risk liability for violation of the borrower's rights to confidentiality.[22]

Even if the bank makes inquiry into the form of consideration for the pledge, and the *bank* is affirmatively misled into believing that the consideration is a non-security, the bank would *still* be liable under the Third Circuit's decision if *in fact,* and despite the bank's knowledge or lack of knowledge, a security was involved and the bank's acts or omissions were somehow remotely tangential to that securities transaction.

Thus, since the bank was unaware of the Weaver/Piccirillo agreement entirely, and unaware particularly that any arrangement between those two parties might be construed as a securities transaction, it can hardly be said that the bank's alleged actions or inactions were "in connection with" a securities transaction. And, since that essential element is left unsatisfied, the bank cannot be liable under the federal securities laws for any losses the Weavers may have suffered from entering into the agreement with the Piccirillos.

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[22] *See, e.g., Peterson* v. *Idaho First National Bank,* 83 Id. 578, 367 P.2d 284, 290 (1961):

> Inviolate secrecy is one of the inherent and fundamental precepts of the relationship of the bank and its customers or depositors. . . . It is implicit in the contract of the bank with its customer or depositor that no information may be disclosed by the bank or its employees concerning the customer's or depositor's account, and that, unless authorized by law or by the customer or depositor, the bank must be held liable for breach of the implied contract.

CONCLUSION

For all of the reasons stated herein, the American Bankers Association respectfully asserts that the trial court correctly granted summary judgment in favor of the petitioner. There are no disputes over material facts in this case and, as a matter of law, a commercial bank certificate of deposit cannot be a security subject to section 10(b) of the Securities Exchange Act of 1934. Moreover, under the undisputed facts of this case, the petitioner's alleged acts and omissions were not in connection with the purchase or sale of an alleged security by and between the respondent and a third party unrelated to the petitioner, and so the petitioner cannot be held liable under the Securities Exchange Act for any damages arising from that transaction. The Third Circuit erred in holding otherwise, and its decision should be reversed.

Respectfully submitted,

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August 6, 1981

The American Bankers Association gratefully acknowledges the advice and counsel of Robert C. Pozen, Esq., Caplin and Drysdale, Washington, D. C., in the preparation of this brief.

EXHIBIT I

MARINE BANK
Serving Northwestern Pennsylvania

CERTIFICATE OF DEPOSIT

Single Maturity ☐
Multiple Maturity ☐
15

No. 38240

Date Feb. 28, 1978

Tax Ident. No. 176-28-8688

This is to certify that there has been deposited in the bank and is payable

10-MARINE BANK-50000dol's00cts

Payable to: Ezra M. or Alice F. Weaver
19-52

Address: RD #4 Union City, PA 16438
19 52

Payable 72 months from date hereof, upon presentation of this certificate, properly endorsed, with interest at the rate of
27-29

7.50 % per annum, computed Quarterly, payable maturity, interest to be ☒ paid by check or ☐ deposited in my
26 19

account no.
83 84-73

This certificate is a contract to keep the funds on deposit until the stated maturity. Should the Bank permit withdrawal of all or part of the deposit before maturity, you will still earn the then current regular savings passbook rate on the withdrawn funds for all but the last three (3) months prior to withdrawal. No interest will be paid on withdrawn funds for the last three (3) months they were on deposit.

Multiple Maturity certificates shall be considered to be redeposited on the same terms and conditions at maturity unless withdrawn by the depositor on a maturity date or within ten (10) days thereafter. The Bank reserves the right to redeem Multiple Maturity certificates by giving written notice to the depositor not less than thirty (30) days prior to any maturity date. Single Maturity certificates are payable upon demand at maturity and cease to accrue interest after that date.

THIS CERTIFICATE IS NOT NEGOTIABLE

By _____
Authorized Signature

2708-R 7/75

1a

No. 80-1562

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1980

MARINE BANK,

Petitioner,

v.

WEAVER,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

CONSENT TO THE FILING OF A BRIEF AS AMICUS CURIAE

In accordance with Rule 36 of the Rules of the Supreme Court of the United States, the undersigned hereby consents to the filing of a brief by the American Bankers Association as amicus curiae in the above-entitled case in support of the Petitioner.

Christine Hall McClure

Christine Hall McClure

Counsel for:

Marine Bank, Petitioner

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Andrew J. Conner, Esquire

Counsel for:

Respondent, WEAVER

Office - Supreme Court, U.S.
FILED
OCT 6 1981
ALEXANDER L. STEVAS

No. 80-1562

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

MARINE BANK, PETITIONER

v.

SAMUEL WEAVER AND ALICE WEAVER, RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR MYRNA AYALA AS AMICUS CURIAE IN SUPPORT OF THE RESPONDENTS

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QUESTIONS PRESENTED

1. Whether a certificate of deposit issued by petitioner, a state bank subject to federal regulation, is a security subject to the antifraud provisions of the federal securities laws.

2. Whether an agreement whereby the respondents were entitled to a share of the profits of an enterprise, and certain other benefits, in consideration of a pledge of the respondents' certificate of deposit to the petitioner, is a security subject to the antifraud provisions of the federal securities laws.

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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

MARINE BANK, PETITIONER

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SAMUEL WEAVER AND ALICE WEAVER, RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR MYRNA AYALA AS AMICUS CURIAE IN SUPPORT OF THE OTHER RESPONDENTS

Interest of Amicus

Myrna Ayala, the amicus herein, is the representative of a class of roughly 100,000 investors in time certificates of deposit issued by a mutual savings bank in New York.[1] These instru-

[1] In *Ayala v. Jamaica Savings Bank*, (1981) Fed. Sec. L. Rep., par. 98,041 (CCH), the bank led investors to believe that their CD's could be redeemed at any time, subject to a penalty. Then without any notice, the bank refused all requests for redemption. As a result investors' funds were frozen and unavailable for extended terms, and at interest rates considerably below those available from competitive instruments.

Most banks in the New York area honored their representations and allowed their CD's to be redeemed. In full-page newspaper ads, however, Jamaica Savings Bank proudly announced that despite the high cost of funds, its earnings had suffered less than those of other banks due to "prudent and conservative policies".

The FDIC has a regulation (12 C.F.R. 329.4(f)) requiring banks to advise their CD investors, in a separate written statement, that their funds might be locked in. Apparently, this requirement has been totally ignored, especially by Jamaica. The FDIC has informally indicated that it considers it more important for banks to be able to lock in funds than for investors to be warned of this possibility.

ments are substantially similar to the certificate of deposit ("CD") acquired from and pledged to Marine Bank by the Weavers. Ms. Ayala believes CD's to be securities entitled to the protections of the Securities Acts of 1933, 15 U.S.C. 77a et seq. (" '33 Act"), and Securities Exchange Act of 1934, 15 U.S.C. 78a et seq. (" '34 Act"). The outcome of this case may determine the outcome of her claims as well.

CD's are simply i.o.u.'s issued by a bank. With limited exceptions, they are promises to pay a certain sum at a certain time together with interest at a certain rate. The only difference between CD's and treasury bills or corporate notes is that CD's are issued by a bank.

The term "CD" is generically applied to several types of bank instruments with various maturities, various terms and conditions, and various interest rates. Some are insured and some are partially insured. Banks also issue similar instruments that are not insured.

In the aggregate, there are hundreds of billions of dollars worth of CD's outstanding at any given time, held by tens of millions of individuals and institutions. Unless the Court's decision is confined very narrowly to the particular facts of this case, these individuals and institutions, as well as tens of thousands of banks, will be significantly affected. Moreover, the reasoning of the Court in even a narrow decision will necessarily provide the basis for countless decisions and transactions. This explains the interest this case has drawn from the American Bankers Association and four government agencies (collectively, the "Government").

Up until this case, the Securities and Exchange Commission ("SEC"), the independent regulatory agency that administers the '33 and '34 Acts, has consistently maintained, in rulings[2] and

[2] In a letter from the Administrator of National Banks to the presidents of all national banks on December 16, 1966, 31 Federal Register 16581, banks were advised that "The Securities and Exchange Commission has expressed the opinion that deposit and share accounts are subject to the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and that advertisements by financial institutions that are contrary to such principles may violate those anti-fraud provisions."

in court,[3] that CD's are securities as defined by those Acts. On August 6, 1981, the Fifth Circuit Court of Appeals, taking heed of the SEC's arguments, reversed a lower court ruling that CD's were not securities.[4]

Without the SEC, there is no one left besides the respondents to assert the interest of individual investors in retaining the remedies and protections of the federal securities laws other than individual investors themselves. The federal bank agencies, as will be shown, lack the tools and authority for this purpose, and in the past, thei solicitude for complaining investors has not been notable. Whether or not the claims of Ms. Ayala's class are typical of those of other purchasers or sellers of bank instruments, these claims bear witness to the fact that claims do arise from time to time, either against banks as sellers or issuers of bank securities or against other persons having some nexus with the purchase and sale of bank securities.

Like the respondents, we believe CD's to be "securities" when secondarily traded, but also, based on the statutes, their legislative history, and the rulings of this Court, at all other stages of their existence as well.

Statement of the Case

In February, 1978, the respondents, Samuel and Alice Weaver ("the Weavers") purchased a $50,000 six-year CD paying interest at 7.5% per annum from Marine Bank, a state bank regulated by Pennsylvania regulatory authorities and by the Federal Deposit Insurance Corporation ("FDIC"). CD's issued by Marine Bank are insured by the FDIC up to $100,000.

In March 1978, Marine Bank approached the Weavers to provide security for a loan by Marine Bank to Columbus Packing

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[3] See footnote 1 of the brief for the United States as Amicus Curiae. Hereinafter, the brief of the United States will be referred to as US Br., the brief of Marine Bank as MB Br. and the brief of the American Bankers Association as ABA Br.

[4] *Meason v. Bank of Miami*, __F.2d__No. 79-3607 (5th Cir. 1981).

Company, a local slaughterhouse and retail meat market owned by Raymond and Barbara Piccirillo ("Piccirillo"). According to the Weavers, they were led to believe that the loan was to provide working capital though, in fact, it would be used for the most part to pay off outstanding unsecured loans by Marine Bank, substantial overdrafts, and various priority creditors of the slaughterhouse. Marine Bank did not disclose the poor financial condition of the slaughterhouse to the Weavers, and disguised that condition by honoring overdrafts of the slaughterhouse to the Weavers.

Without appreciating the precarious position of the slaughterhouse, the Weavers pledged their CD as collateral for the "new" loan to the slaughterhouse. In consideration of their pledge, the Weavers obtained from Piccirillo an agreement to participate to the extent of fifty percent of the profits of the slaughterhouse, one hundred dollars a month, and the right to graze cattle on slaughterhouse property.

No sooner had the pledge been made than the situation deterioriated. Checks from the slaughterhouse to the Weavers were dishonored, within weeks the slaughterhouse was out of business, and Marine Bank initiated steps to apply the collateral to the outstanding balance of the "new" loan. In effect, the Weavers "sold" their CD to Marine Bank for nothing.

Summary of Argument

The fraud in this case is straightforward. Marine Bank was not a mere aider and abettor, but was the principal promoter and beneficiary of the scheme. Marine Bank's defenses are utterly repugnant to the federal securities laws, and if permitted, would nullify the effect of those laws.

The decision of the Third Circuit Court of Appeals is soundly based upon the structure, language, and purposes of the federal securities laws, as well as upon the economic realities of the financial markets. The coverage of the '33 and '34 Acts, being remedial in nature, was broadly written to include a wide range

of financial instruments. Narrow groups of these instruments are classified as "exempted securities" and relieved from compliance with some, but not all, of the provisions of the Acts. Not even "exempted securities" are excused from the antifraud provisions.

CD's are covered several times over in the definitional sections of the Acts, as notes, bonds, evidences of indebtedness, or investment contracts. Under the '33 Act (but not the '34 Act), securities issued or guaranteed by banks are exempted from the registration requirements of that Act, a meaningless exemption unless coverage existed to begin with.[5] As found by the Third Circuit, CD's are the functional equivalent of bonds or notes, and compete head to head with the increasing variety of financial instruments available to the public, many of them offered by banks themselves. The Court previously held savings accounts to be securities.[6] CD's are equally subject to that classification.

Marine Bank's principal argument, that the Court should override the express language and structure of the '33 and '34 Acts because CD's are "safe" and "regulated", misses the essential purpose of the Acts,

> "(T)o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce

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[5] It was this rationale that, in part, led the Court to conclude that savings accounts of a state regulated savings and loan associations were securities, in *Tcherepnin v. Knight*, 389 U.S. 332 (1967). See also note 6, *infra*.

[6] In *Tcherephin v. Knight, supra* the Court held savings accounts in a savings and loan association to be securities. The securities there were called "withdrawable capital shares", but a savings account by any other name still has the same investment characteristics. In mutual savings and loan associations, holders of savings accounts, and even borrowers, get a vote.

Savings accounts are not fixed income instruments. Nothing prevents a bank from adjusting the returns, whether characterized as "dividends" or "interest", upward or downward or paying nothing at all, except for the availability of earnings of the bank and the upper limit imposed by the FDIC and Federal Savings and Loan Insurance Corporation ("FSLIC"). That upper limit is in the process being gradually eliminated under the Depository Institutions Deregulation Act of 1980, 12 U.S.C. Sec. 3501 et seq.

Nor are savings accounts especially liquid. Banks may, and often do, impose thirty day notice requirements on withdrawals.

> and through the mails, and to prevent frauds in the sale thereof. . ." 15 U.S.C. 77b (preamble).

A security itself may be perfectly safe, but that does not prevent mischaracterization of its value, terms, return, liquidity, resale market, tax attributes, or many other material features. It does not prevent mischaracterization of what is given or taken in exchange for a security or frauds generally in connection with securities.

Moreover this argument proves far too much. A nearly infinite range of securities which are "safe" and whose issuers are regulated could easily qualify by such a measure. Logically extended, this argument would eliminate antifraud protection in regard to many presently covered securities, such as treasury securities, state and municipal securities, securities issued or guaranteed by Federal or Government National Mortgage Associations, public utilities, insurance companies, common carriers, and many others.

Securities and bank regulatory statutes were enacted for different purposes. Bank regulation does not begin to provide an adequate substitute for the protections and remedies of the federal securities laws. Regulation in one respect does not mean regulation in all respects.

Nor is there any evidence that Congress intended bank regulation to be a substitute for federal securities law protection other than the explicit classification of bank securities as "exempted securities" for purposes of the registration provisions of the '33 Act. The coverage intended by Congress was clearly expressed in the '33 and '34 Acts in explicit, substantive provisions. The relationship with other laws was clearly expressed as well. The '33 and '34 Acts both provide that the rights and remedies provided therein "shall be in addition" to any and all other rights and remedies.

The net result of the transactions giving rise to this case was that Marine Bank acquired a valuable security from the Weavers in exchange for something worthless. The federal banking laws are no help to the Weavers, but this is precisely the type of situation intended to be covered by the federal securities laws.

Argument

I. The Structure, Language, and Purposes of the '33 and '34 Acts Require That CD's Be Considered Securities.

A. Structure

Both the '33 and '34 Acts begin with definitions of "security" that are

> "in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security."[7]

The American Bankers Association argues that the definition is an "exhaustive" list,[8] and the absence of CD's from that list is conclusive based on the *inclusio unius* rule of statutory construction. Plainly, Congress did not attempt to name every type of security then known or to conceive of every variety of financial vehicle which might be devised in the future, and if it had, the ingenuity of the financial markets would be equal to the task of fashioning a new instrument unnamed in the definition. Neither syndicated citrus groves nor oil leases are specifically included in the definition, yet the Court has held such instruments to be securities.[9]

After beginning with broad coverage, Congress carved out limited areas where coverage was believed unnecessary. Unlike the general definition, the list of exceptions is "exhaustive", and is found under Section 3 of the '33 Act, 15 U.S.C. 77c, and Section 3(a)(12), 15 U.S.C. 78c(a)(12), of the '34 Act, describing "exempted securities". CD's are on the first list in Section 3(a)(2), 15 U.S.C. 77c(2), as "any security issued or guaranteed

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[7] H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 11.

[8] A.B.A. Br., p. 5.

[9] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1934).

by any bank." To the extent CD's are insured by the FDIC, CD's are covered by the language "any security . . . guaranteed by . . . any person controlled or supervised by and acting as an instrumentality of the Government". Likewise exempted are securities of savings and loan associations, such as those involved in *Tcherepnin v. Knight, supra.*

Not even "exempted securities" are relieved from compliance with the antifraud provisions. Section 17(c) of the '33 Act, 15 U.S.C. 77q(c), provides:

> "The exemptions provided in Section 3 shall not apply to the provisions of this section."

Under the '34 Act, "exempted securities" are subjected to the antifraud provisions in Section 10, 15 U.S.C. 78j, and bank securities, other than short-term notes and bankers' acceptances, are not even "exempted securities".

The legislative history of the '33 Act indicates that Congress took the fact of bank supervision into account in exempting bank securities from the registration requirements.[10] No one was then bold enough to suggest that banks should be absolutely relieved of liability under the antifraud provisions.

As stated by the Fifth Circuit in *Lehigh Valley Trust Company v. Central National Bank*, 409 F.2d 989, 992-993 (1969):

> "(T)he fact that Congress exempted from the registration requirements of the Securities Act of 1933 the securities of any '(national bank or other) banking institution * * * the business of which is substantially confined to banking and is supervised by the State * * * banking commission * * *' * * * indicates that Congress was aware of the peculiar problems and strengths of banks resulting from their regulation by state and federal banking statutes. That Congress made no express exemption for banks under the fraud provisions * * * indicates that Congress did not intend any such exemption."

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[10] H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 14.

The Government argues that since the same Congress passed the Glass-Steagall Act[11] and the '33 Act, there must have been a *sub rosa* intention to exempt bank securities from coverage altogether. Juxtaposition of time in the passage of legislation is a bizarre basis for statutory exclusion, and if established as a principle of construction, would lead to endless mischief. If anything, the consciousness of current legislation should have led Congress to deal explicitly with the situation of banks in the '33 Act, as indeed it did. Both statutes have been amended and supplemented several times without the claimed exclusion being made explicit.

B. Language

"Security" is defined in Section 2(1) of the '33 Act, 15 U.S.C. 77b(1), as follows:

> "Sec. 2. When used in this title, unless the context otherwise requires—
>
> (1) The term security means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."[12]

CD's can be aptly classified as bonds, notes, evidences of indebtedness, or investment contracts.

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[11] 48 Stat. 162, ch. 89 (1933).

[12] The '34 Act definition in Section 3(a)(10) 15 U.S.C. 78c(a)(10), is virtually identical, and has been read as such by the Court. The '34 Act definition, however, does not contain the phrase "evidence of indebtedness."

The Government concedes "literal" coverage of CD's by the definition, but Marine Bank and the American Bankers Association resist the obvious. They argue that unless instruments return, or promise to return, profits that vary directly with profits of the issuer, those instruments are not "securities". In other words, fixed income instruments are not securities, and bonds, notes, and debentures, as well as evidences of indebtedness, equipment trust certificates, and preferred stock, should be read out of the '33 Act. A substantial proportion, if not a majority in terms of dollar volume, of securities registered last year with the SEC were fixed income instruments. If nothing else, fixed income instruments fit the "commonly known as securities" language of the definition.

The Government places greatest reliance on the introductory language of Section 2—"unless the context otherwise requires". Whatever was intended by this phrase, it was clearly not meant as a delegation to the courts of legislative power to create broad classes of coverage or exclusion, thus substituting their judgment for that of Congress, as is being urged here. Before the Court overrides the explicit language of the Acts, it should have before it more compelling evidence of Congressional intent than has been presented in this case. The inability of Huston Thompson, then a lawyer in private practice, to envision on the spot the myriad bank instruments sold today should not foreclose the Court from interpreting the language of the Acts according to its plain meaning.[13]

The best interpretation of the "context" language is as a *de minimis* rule applied to particular factual situations.[14] If the

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[13] Mr. Thompson himself stated, referring to the securities covered by the '33 Act, "It would be any kind of security of a national bank." Hearings on H.R. 4314, before House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 31 (1933).

[14] In *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2nd Cir. 1976), the Second Circuit placed emphasis on the word "requires". Nothing in the federal banking laws *requires* exclusion of CD's from the '33 and '34 Acts. Even the Court in *Bellah v. First National Bank*, 495 F.2d 1109 (5th Cir. 1974), did not hold that CD's were not securities, but merely expressed skepticism in the setting of that case before remanding for a determination of that issue. The Court in *Canadian Imperial Bank v. Fingland*, 615 F.2 465, 470 (7th Cir. 1980), confined its ruling to the particular facts of

"context" in this case can be stretched to include all the federal and state banking statutes and regulations, then it must also be stretched to include the investment in CD's of several hundred billion dollars by tens of millions of investors. That the CD sold to the Weavers was not the only CD sold by Marine Bank, that Marine Bank sold its CD's to the public as investments, and that the Weavers were not in the business of making loans to banks, must also be considered as part of the context.[15]

C. Purposes

The '33 and '34 Acts regulate disclosure and prohibit frauds concerning securities. The intrinsic worth or "safety" of securities is not their concern, and, as this Court stated in *SEC v. Howey, supra,* is not a proper basis for exclusion from coverage. Even the terms of "safe" securities can be misrepresented. Even "safe" securities can be sold for too much, bought for too little, or otherwise dealt with in a fraudulent manner.

With safe, regulated securities excluded from coverage, the '33 and '34 Acts would cease to apply to treasury securities, state and municipal securities, securities issued or guaranteed by Federal and Government National Mortage Associations, the Farmers Home Administration, public utilities, insurance companies, common carriers, and many others.

Nor does such a measure withstand scrutiny. "Safety" in the context of the financial markets is a relative concept, heavily

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that case. In withdrawing its prior opinion, the Court in *MacKethan v. Burrus, Cootes and Burrus,* 545 F.2d 1388, 1391 (4th Cir. 1976), said "Yet we deem it appropriate to emphasize that we are not taking any position on the question (1) whether the District Judge was justified in ruling as a matter of law, instead of submitting to the jury, the issue whether NS&L certificates of investment were "securities" within the meaning of Section 3(a)(10) of the ('34 Act). . ."

[15] The "context" might also include the fact that banks issue a variety of instruments to the public, some of which are insured, some of which are not, and some of which are partially insured. "Variable rate notes," CD's whose interest rate fluctuates according to certain indices, and "repurchase agreements," whereby investors buy an interest in a pool of money market instruments, closely resemble mutual funds. The "context" might also include the fact that banks compete aggressively for capital, using full page ads, songs and jingles, celebrity spokespersons, "free" kitchenware, and "finders fees".

dependent on the circumstances. During the depression, having money in a "good" bank (as opposed, one assumes, to a "bad" bank), may have been safe, but compared to the stock market (or a "bad" bank), even a mattress was safer. Times have changed. If the Weavers still held their CD today, after giving effect to inflation and taxes, their investment would have lost roughly thirty percent of its initial value. Sophisticated bond traders, dealing in even "safer" securities, have done as poorly. One man's safety is another man's financial debacle.

A corollary purpose of the '33 and '34 Acts is the protection of investors. These Acts were were passed to remedy the evils in securities sales and trading that contributed to the market collapse and to the public lack of confidence in the financial markets. On the other hand, nothing in these Acts or their legislative history reveals any intention to protect banks or other commercial lenders from borrowers.

Since protection of commercial lenders was not a purpose of the Acts, some courts have adopted the "commercial/investment" dichotomy. As stated by the Court in *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972), in distinguishing investment and commercial note transactions:

> "When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment."

Basically, a debtor/creditor relationship is something different from the "ordinary concept of a security."

Yet where securities were pledged to a bank to secure a loan, as in *Rubin v. United States*, 100 S.Ct. 698 (1981), the federal securities laws were held to apply. Presumably, had the bank been charged with violating the federal securities laws, as in this case, coverage would also have existed.

II. The Economic Realities Are That CD's Are Securities.

When investors purchase CD's, they are doing something more than parking their capital at a bank and getting a receipt, like some kind of bailment.[16] CD's more closely resemble treasury bonds than "demand deposits" or "safe deposits" that pay no return. The investment features are predominant. Money market funds, 22% of whose assets in the aggregate consist of CD's, invest in CD's primarily for the return. So does everyone else.

CD's compete with, and are offered as attractive alternatives to government obligations, utility bonds, money market funds, and wrap-around annuities, all indisputedly securities. The nature of an instrument, not its origin, should be determinative. Moreover, in a review of contemporary financial markets, Morris Crawford, Jr., Chairman of the Bowery Savings Bank, New York's largest, wrote:

> "While it appears that savings banks do not offer a significant hedge against inflation, they have competed aggressively and successfully over the past ten years with such other investments as stocks, bonds and mutual funds."[17]

The vehicles for such competition by savings banks were CD's and savings accounts.[18]

As mentioned earlier, the Court has held savings accounts of a state regulated savings and loan association to be securities.[19] Although these securities, typical of mutual savings and loan

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[16] CD's can no more accurately be described as "currency deposits", the phrase used by Marine Bank, than corporate securities can be described as "currency bonds" or "currency stocks".

[17] M. CRAWFORD, "The Bedrock," in LEVITT, ed., HOW TO MAKE YOUR MONEY MAKE MONEY 17 (1981).

[18] As stated by the Court in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1934), a financial instrument may be classified by the instruments against which it competes for investors.

[19] *Tcherepnin v. Knight, supra.*

associations, entitled holders to a vote, it is doubtful that the voting feature was of any material investment significance or was ever a strong inducement for purchase. Many other securities, including the majority of securities listed in Section 2(1) of the '33 Act, 15 U.S.C. 77b(1), do not involve voting.

In the past, when the Court spoke of "economic realities", it was referring in part to the *Howey* test, as applied in *United States Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). That test, investment in a common enterprise with the expectation of profits from the efforts of others, is readily met by the Weavers' CD. The money invested in banks does not remain at rest, but is accumulated and reinvested for a return. Investment in bank instruments is substantially similar to investment in a pool of loans and securities arranged and purchased by the bank. A bank is every bit the common enterprise that the savings and loan association was in *Tcherepnin v. Knight, supra.*[20]

The investor in bank securities, as opposed to demand deposits, that are made for safety and convenience, expects a return at the rate agreed upon, as in the case of CD's, or at the rate determined from time to time by the bank's board of governors, as in the case of savings accounts.[21]

III. Bank Regulation Does Not Substitute For or Conflict With the '33 and '34 Acts.

CD's, unlike involuntary, non-contributory interests in labor union pension funds, are a staple of the financial markets. To acquire a CD, one must invest capital, not labor. Those acquiring

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[20] By use of the term "deposit", banks seek to preserve the illusion that all its "deposits" are sitting in a vault somewhere. This, of course, is nonsense. All but a small fraction are out somewhere working to earn more money.

[21] The District Court in *Ayala v. Jamaica Savings Bank, supra*, expressed the view that since most of the CD's were FDIC insured, the investors were not looking to "*others*" for profits. However, the FDIC appears for all intents and purposes to be an "other". Such insurance is not the equivalent of the investor mixing his own labor with the enterprise. Federal insurance does not prevent Government National Mortgage Association-backed instruments, for example, from being considered "securities".

CD's, unlike labor union members, have a choice of a variety of financial instruments. CD's, unlike pension rights, are assignable, and in institutional circles, are freely traded and exchanged.

Were this not sufficient to distinguish the interests involved in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), from CD's, it can be further said that the federal laws governing pensions provide substantive individual rights and remedies.[22]

An examination of the federal banking statutes and the regulations issued thereunder reveals that there are no individual rights or remedies. This is a far cry from the rights to bring civil actions and to obtain damages, rescission or restitution under the '33 and '34 Acts. Nor do the federal bank agencies have the power to order or cause these remedies.

Under the statutes applicable to Marine Bank, for example,[23] the FDIC may, if it detects "unsafe or unsound" practices or violations of regulations, issue a "notice of charges". At least thirty days later a hearing is held, and thirty days after that a cease and desist order may be issued. A temporary cease and desist order may be issued where the perceived misconduct "is likely to cause insolvency or substantial dissipation of assets or earnings of the bank or otherwise seriously prejudice the interests of its depositors" prior to completion of the more lengthy cease and desist order proceedings. Officers may be removed for engaging in unsafe or unsound practices, or for breaches of fiduciary duty to the bank where the bank has or probably will suffer "substantial financial loss", the interests of depositors generally is "seriously prejudiced" or the officer has profited personally.

Whether these provisions benefit a defrauded individual is doubtful. They are primarily designed to protect the institution as opposed to those dealing with it. What is certain is that they provide no relief for damage already done. Nothing permits the bank agencies to penalize or obtain remedies from the bank institutions themselves, other than to deny insurance coverage,

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[22] See 29 U.S.C. Sec. 1132.

[23] 12 U.S.C. (Supp. III) 1818.

thereby possibly injuring those defrauded. They fall far short of the fines, forfeitures, criminal sanctions, and equitable remedies under the '33 and '34 Acts.

The same may be said for the regulations, whose purpose is largely to prevent, or at least regulate, economic competition among the banks. Although the regulations prohibit misrepresenting "interest" and "deposit contracts", they do not prohibit misrepresentations of anything else.[24] They do not prevent the bank from simply omitting to state material facts. Most importantly, they provide no remedies whatsoever.

The federal banking statutes and federal securities statutes were, as all seem to agree, passed for different purposes; the first to insure the financial stability of banks, and the second to insure full and fair disclosure in the financial markets. In no way can these sets of statutes be considered substitutes for each other. The bank agencies do not have the authority, resources, or motivation to police the financial markets. Their charter is to prevent bank failures either through poor management or through a "run on the bank" set in motion by a loss of confidence. Unless the stability of the institution is jeopardized, the bank agencies are not concerned with individual transactions.

Ironically, while the Government argues to the Court that the protections of the federal securities laws are unnecessary because of the Glass-Steagall Act, the Justice Department is arguing to Congress that the protections of the Glass-Steagall Act are unnecessary because of the protections of the federal securities laws.[25]

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[24] See, e.g. 12 C.F.R. 329.8(f), which applies to Marine Bank.

[25] On September 10, 1981, John C. Filippini, Chief, Legislative Unit, Antitrust Division, United States Department of Justice, in a speech to the Federal Bar Association, said, "On July 8, 1981, Assistant Attorney General Baxter testified before the House Judiciary Committee Subcommittee on Monopolies and Commercial Law concerning the structure of the financial services industries . . . The Department of Justice believes . . . that securities and other forms of government regulation put in place after the Glass-Steagall Act's enactment in 1933 may largely have lessened the potential for abuses in both commercial banking and securities activities that led to passage of that Act. If this belief is accurate, Glass-Steagall prohibitions may be eliminated or substantially reduced without affecting the stability and soundness of the commercial banking system."

This apparent lack of coordination, apart from the obvious conflict, demonstrates the folly of giving the '33 and '34 Acts a kaleidoscopic character whose meaning shifts and changes depending upon what other laws might be on the books at any given time.

The '33 and '34 Acts should stand alone, made clear by their own words, without an exhaustive search of the United States Code. Aside from occasional cross references to the Internal Revenue Code, nothing in those Acts or in their legislative history reveals any intention that they be subservient to any other act of Congress. Indeed, Section 16 of the '33 Act, 15 U.S.C. 77p, provides. "The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity."[26] The express words and purposes of those Acts should enjoy a strong presumption, and should be overridden only by something even stronger. The sparse bits of ambiguous legislative history put forth by the Government do not begin to justify reversal of express legislative determinations.

What we are faced with in this case is not the prospect of "duplicative and unnecessary regulation," but rather the simple requirement that when banks take other peoples' money based on the promise of a return, or when they otherwise deal with instruments thus created, they tell the truth. Most banks are not burdened in the least by that requirement.

There is no reason why savings and loan associations should be held to this requirement while commercial banks, such as Marine Bank, remain immune. The fears of bank agencies that this requirement "would inhibit the ability of banks to attract deposits" and "unduly raise compliance costs"[27] do not justify

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[26] See also Section 28(a) of the '34 Act, 15 U.S.C. 78cc(a).

[27] As stated by the SEC in its brief in *Meason, supra*, "certain banks are already subject to affirmative disclosure requirements under Section 12(i) of the Securities Exchange Act, 15 U.S.C. 781(i), which requires that banks with publicly-held common stock file periodic reports, similar to those prepared by other publicly-held cororations, with the appropriate federal bank regulatory agency. The regulations adopted by the bank regulatory agencies pursuant to Section 12(i) of the Securities Exchange Act include requirements that the banks file current reports within ten days after the close of the month in which

overriding express Congressional mandates. Nor is there anything in the federal banking laws requiring or authorizing banks to raise capital by means inconsistent with the federal securities laws.

IV. Identical Language In Closely Related Statutes Should Not, As Urged, Be Given Opposite Meanings.

The SEC argues that under the Investment Company Act of 1940, 15 U.S.C. 8a-1 et seq. (" '40 Act"), CD's are securities and that the Court should either so indicate or else restrict its opinion so that coverage under the '40 Act might still be claimed. The definition of "security" in the '40 Act is identical, word for word, to the definition in the '33 Act. One of the decisions relied upon by the Government to support its '33 and '34 Act position arose under the '40 Act.[28] In essence, the SEC is asking that identical language in closely related and interdependent statutes be given opposite interpretations, and that CD's when bought and sold are not "securities", but once they come to rest and are held, they are magically transmuted into "securities". Congress deserves greater credit for logic and consistency. There is no evidence of Congressional intent to support such an approach.

The reasons given for considering CD's as securities under the '40 Act are reasons for considering CD's securities under the '33 and '34 Acts as well. It is not the intrinsic "safety" of an instrument that matters, but what is done, said, or not said about it, that concerns the federal securities laws.

This is not to say that the only partially expressed fears of the SEC are unfounded. A holding that CD's are not securities would create a gaping loophole not only in the '40 Act, but in

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certain events occur. *See* Form F-3, 12 C.F.R. 11.43; Form F-3, 12 C.F.R. 206.43; Form F-3, 12 C.F.R. 335.43. Defendants do not claim that these affirmative disclosure requirements have imposed intolerable burdens, caused a 'panic' or a 'run' on any banking institution subject to those provisions, or interfered with any needs of the banking industry for confidentiality."

[28] *Drovers Bank v. SFC Corporation*, 1452 F.Supp. 580 (N.D. Ill. 1978).

several provisions of the Internal Revenue Code that are dependent on '40 Act coverage. The result, in the absence of new legislation, would be a dramatic restructuring of the financial markets, an explosion of "offshore" funds, a huge loss of tax revenues, and colossal uncertainty.

Greatly simplified, Section 1246 of the Internal Revenue Code discourages money market funds from locating in tax havens, avoiding income taxes, and then remitting income in the form of capital gains to shareholders who redeem their stock, by taxing those gains as ordinary income. Such entities, known as "foreign investment companies", are defined as foreign corporations engaged primarily in the business of investing in "securities" as defined under the '40 Act. If CD's are not "securities" under the '40 Act, a money market fund could locate in a tax haven, invest primarily in CD's, and offer yields roughly fifty percent greater than other funds.[29]

Despite the financial incentive, the movement of money market funds offshore has not occurred because the financial markets have assumed and become comfortable with the knowledge that CD's are securities. Thus, in the financial markets, if not in western Pennsylvania, CD's are "commonly known as securities".

V. The Fraud Upon The Weavers Was of The Type Intended To Be Covered By The '33 And '34 Acts.

In *Superintendant of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), there was nothing intrinsically wrong with the treasury securities employed as part of that fraudulent scheme.[30] Similarly, the intrinsic worth of the Weavers' CD did not prevent a scheme to deprive them of its value in exchange for something worthless.

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[29] Havoc would also be played under Subchapter M of the Internal Revenue Code, which deals with taxation of investment companies, and is also tied in to the provisions of the '40 Act.

[30] It is instructive that the regulating agency involved in that case resorted to the securities laws for a remedy.

The extent to which Marine Bank can minimize its role in this scheme is limited. Marine Bank was the principal promoter and beneficiary of the scheme. Its position is totally different from that of the accountants in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), who failed to uncover a fraudulent scheme, but did not themselves benefit from it. Even if Marine Bank did not know precisely what the Weavers were getting, it knew precisely that whatever it was had little or no value.

Marine Bank suggests that the Weavers should have known that any person needing outside collateral is in desperate financial condition.[31] But not all collateralized loans fail. Few fail soon as the collateral is delivered. The Weavers undoubtedly thought there was some risk involving the pledge of their CD, but not an ironclad certainty that their CD would almost instantly disappear.

Marine Bank suggests that it could not have disclosed material facts to the Weavers concerning the financial condition of the slaughterhouse or concerning Marine Bank's involvement since to do so would violate duties of confidentiality.[32] But self-imposed duties of confidentiality cannot be preferred over the duties under the federal securities laws, and must be qualified to that extent.

It is important here to emphasize the advantages of the anti-fraud provisions of the federal securities laws over the rules of common law fraud. The former not only establish a nationwide rule for financial markets, but, unlike common law fraud, establish liability for non-disclosures.[33] Securities transactions are held to a higher standard than *caveat emptor*, as Congress believed they must be to maintain confidence in the financial markets.

Although not principally concerned with the agreement whereby the Weavers were entitled to fifty percent of the profits of the Piccirillo slaughterhouse, one hundred dollars a month, and grazing rights, in exchange for their pledge to Marine Bank ("Piccirillo Agreement"), we must note that the Piccirillo Agreement certainly appears to have all the indicia of a "profit-sharing

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[31] M.B. Br. fn. 22.

[32] Id.

[33] See L. LOSS, SECURITIES REGULATION 1434 (2nd ed. 1961).

agreement" or "investment contract".[34] It bears little resemblance to a commercial lending agreement. No commercial lender would accept such terms, and the Weavers were not in the business of entering into profit-sharing agreements. The Agreement easily passes all the tests formulated by the American Bankers Association to be applied to CD's, just as CD's easily pass all the tests formulated by the Government to be applied to the Piccirillo Agreement.

VI. Conclusion.

Investors acquire and dispose of securities for a variety of reasons, safety being only one. In all cases, investors wish to receive what they reasonably expected without constant concern about what is being withheld or concealed. When they are cheated, they want entitlement to a remedy. The federal securities laws were intended to fulfill these needs and desires. The federal banking laws were not.

This case is not the occasion to relieve bank instruments of the requirements of full and fair disclosure. With the Depository Institution Deregulation Act of 1980 coming into effect, with further attempts being made to eliminate regulation, and with all the other rapid changes now taking place in the financial markets, the standards and assurances provided by the federal securities laws are needed more than ever.

If CD's were subjected to a "blind" test without reference to who or what the issuer was, the result would be automatic. CD's are widely offered to the public as attractive investments. They easily meet the *Howey/Forman* tests. They fit comfortably within the definitional language. No logical reason exists for commercial bank securities to be given a preferred status over those of savings and loan associations or over those of the federal government itself.

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[34] Instruments are not typically described by the consideration given for them. The Piccirillo Agreement is no more a "loan guarantee agreement", the label used by the Government, than stock options are "money payment agreements".

For all the foregoing reasons, as well as those advanced in the brief of the respondents, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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OCTOBER TERM, 1980

MARINE BANK, PETITIONER

v.

SAMUEL WEAVER AND ALICE WEAVER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTIONS PRESENTED

1. Whether a certificate of deposit issued by petitioner, a federally regulated bank, is a security subject to the antifraud provisions of the federal securities laws.

2. Whether an agreement requiring respondents to guarantee a bank loan, in return for a percentage of the profits of the borrower and certain other cash and non-cash benefits, is a security subject to the antifraud provisions of the federal securities laws.

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In the Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-1562

MARINE BANK, PETITIONER

v.

SAMUEL WEAVER AND ALICE WEAVER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

INTEREST OF THE UNITED STATES

This case presents the question whether the antifraud provisions of the federal securities laws apply to a certificate of deposit issued by a federally regulated bank. That question turns on whether such an instrument is a "security" for purposes of those provisions. Although this case calls for an interpretation of the federal securities laws, it is of significance not only to the Securities and Exchange Commission ("SEC"), the agency responsible for administration and enforcement of those laws, but also to the federal bank regulatory agencies—principally the Comptroller of the Currency ("Comptroller"), the Board of Governors of the Federal Reserve System ("Board of Governors"), and the Federal Deposit Insurance Corporation ("FDIC").

The SEC is of the view that the certificate of deposit involved here is not a security in the context of this case. However, the SEC is concerned that the term "security"

not be construed in a way that would call into question the applicability of the securities laws in other contexts. The federal bank regulatory agencies are of the view that certificates of deposit issued by federally regulated banks are not securities under the antifraud provisions of the federal securities laws. Those agencies are concerned that a holding that certificates of deposit are securities would inhibit the ability of banks to attract deposits necessary for the efficient functioning of the nation's banking system, would unduly raise compliance costs, and would interfere with the pervasive scheme of bank regulation prescribed by Congress. The result reached by the court of appeals would, in the view of the federal bank regulatory agencies, have an adverse impact on the daily business of banks engaged in deposit transactions and would result in duplicative and unnecessary regulation.

The SEC and the federal bank regulatory agencies have in the past taken differing positions with respect to the application of the federal securities laws to certain deposit instruments.[1] All of these agencies and the United States believe, however, that the position jointly advocated in this amicus curiae brief—that the certificate of deposit issued by petitioner is not a security in the context of this case—is consistent with congressional intent in enacting the federal securities and banking laws.

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[1] The SEC and the FDIC filed opposing amicus curiae briefs in *Schutte* v. *Bank of Miami*, appeal pending, No. 79-3607 (5th Cir.) (involving certificates of deposit of an off-shore unregulated bank); *Adato* v. *Kagan*, 599 F.2d 1111 (2d Cir. 1979) (involving certificates of deposit of a state-chartered FDIC insured bank); *Safeway Portland Employees' Credit Union* v. *C.H. Wagner & Co.*, 501 F.2d 1120 (9th Cir. 1974) (same). The Comptroller opposed the SEC's position both in the *Safeway* case and in *Burrus, Cootes & Burrus* v. *MacKethan*, 537 F.2d 1262 (4th Cir.), opinion withdrawn and prior judgment aff'd on other grounds, 545 F.2d 1388 (1976), cert. denied, 434 U.S. 826 (1977) (involving certificates of investment issued by an industrial loan corporation).

This case also involves the question whether a loan guarantee agreement is an "investment contract," a term included in the definition of "security" prescribed in the federal securities laws. The SEC and the United States believe that the loan guarantee agreement here at issue is not a security.[2] However, since the traditionally broad interpretation given the term "investment contract" by this Court has proven to be indispensable in policing fraudulent schemes involving non-conventional investment vehicles, the SEC is concerned that the term not be narrowly construed.

STATEMENT

1. Respondents Samuel and Alice Weaver filed suit in the United States District Court for the Western District of Pennsylvania, alleging that they were defrauded by petitioner Marine Bank, a state-chartered commercial bank whose deposits are insured by the FDIC (C.A. App. 4a-12a).[3] Their claims arose from certain transactions involving the Columbus Packing Company, a proprietorship owned by Raymond and Barbara Piccirillo that engages in the wholesale slaughtering and meat packing business. The complaint alleged that the bank induced the Weavers, who are farmers and owners of a cattle auction business, to guarantee a loan to Columbus Packing Company and to secure that guarantee by pledging a $50,000 certificate of deposit (*id.* at 5a). The interest-bearing certificate of deposit, which was issued two months earlier by the bank, had a maturity of six years (Pet. App. A-3). In consideration for their guarantee of the bank loan, the Weavers entered into an agreement with Mr. and Mrs. Piccirillo whereby the Weavers were

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[2] The federal bank regulatory agencies take no position concerning the status under the federal securities laws of the loan guarantee agreement.

[3] "C.A. App." refers to the two volume "appendix for appellants" in the court of appeals.

given the right to use Columbus Packing Company's barn and pastures, to receive 50% of any net profit the company might earn, and to receive $100 per month (C.A. App. 13a-14a).

Mr. Weaver testified during his deposition that he had been asked by Mr. Piccirillo and Marine Bank officials to provide "working capital" to Columbus Packing Company (C.A. App. 303a, 305a-306a). Although Mr. Weaver knew that his agreement with the Piccirillos would give him "a little share" of the business, he never asked for such an interest (*id.* at 318a-319a). Mr. Weaver also testified that he believed he would not lose money on the transaction because (1) Marine Bank's loans to Columbus Packing Company were secured by collateral and (2) Mr. Piccirillo had given him a note for $10,000 secured by Mr. Piccirillo's father's house (*id.* at 310a, 318a). Mrs. Weaver testified that the reason for assisting Mr. Piccirillo was that "he would buy cattle from us, and that would help us" (*id.* at 347a).

The Weavers claimed that both the certificate of deposit that they had pledged to secure the loan and their guarantee agreement with the Piccirillos were "securities" and that they had been induced to enter into these security transactions through misrepresentations by employees of the bank (C.A. App. 104a-105a). They further alleged that Columbus Packing Company had filed a petition in bankruptcy shortly after receiving the loan and that Marine Bank intended to apply the pledged certificate of deposit toward the loan deficiency (*id.* at 8a-9a). They claimed that the misrepresentations by the bank violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, as well as Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a) (C.A. App. 106a, 108a).[4]

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[4] The Weavers' claim concerning the certificate of deposit and the allegations of a violation of Section 17(a) of the Securities

2. The district court granted Marine Bank's motion for summary judgment, concluding that neither the certificate of deposit nor the loan guarantee agreement was a "security" (Pet. App. A-25 to A-29). A divided court of appeals reversed (*id.* at A-1 to A-23). The majority held that a jury could find that the certificate of deposit was the "functional equivalent" of a long term bond or note and thus was a security (*id.* at A-12). The court also held that the loan guarantee agreement could be viewed as either a "certificate of interest or participation in a profit sharing agreement" or an "investment contract," both of which are embraced within the definition of "security" prescribed in Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10) (Pet. App. A-9).

SUMMARY OF ARGUMENT

1. In determining whether the certificate of deposit issued by petitioner is a security subject to the antifraud provisions of the federal securities laws, it is appropriate to begin with the language of the statutes. *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979). Although the definition of "security" contained in the federal securities laws is broad and the instrument involved here could be found to fall within its literal language, that definition is qualified by the prefatory clause "unless the context otherwise requires * * *." The legislative history of that clause, and the decisions construing it, establish that courts are not bound by the literal terms of the statutory definition in all cases, and should not treat particular instruments as "securities" if that would extend the federal securities laws to contexts not intended to be regulated by those laws.

Act of 1933 first appeared in a proposed amended complaint (C.A. App. 104a-108a). The district court, although denying leave to amend the complaint, considered the allegations in the proposed amendment as if set forth in the original complaint (Pet. App. A-42).

The context here is a transaction involving a certificate of deposit issued by a federally regulated bank. Federal banking statutes provide comprehensive regulation of all phases of banking operations—regulation carefully designed to assure financial soundness and to protect depositors against failure to repay principal and interest. The protection afforded by this comprehensive scheme of regulation substantially eliminates the need for application of the antifraud provisions of the securities laws. Moreover, as the legislative history indicates, Congress intended that deposit transactions of federally regulated banks would be governed not by the securities laws but by the banking statutes, certain of which were enacted almost simultaneously with the Securities Act of 1933. The conclusion that the certificate of deposit involved here is not a security subject to the antifraud provisions of the federal securities laws harmonizes the federal securities and banking laws, and avoids overlapping jurisdiction that would "serve[] no general purpose." *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 570.

2. This Court need not determine whether the loan guarantee agreement entered into by the Weavers could be characterized "a certificate of interest or participation in any profit sharing agreement" or an "investment contract." Examination of the "context" of this privately negotiated agreement plainly demonstrates that it does not have the economic characteristics of a security and that application of the federal securities laws would depart from Congress' intent.

ARGUMENT

I. THE CERTIFICATE OF DEPOSIT AT ISSUE IN THIS CASE IS NOT A SECURITY SUBJECT TO THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS

The court of appeals held that a certificate of deposit issued by petitioner, a federally regulated bank, is a

"security" subject to the antifraud provisions of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act. Whether an instrument is a security is a matter of statutory construction. In construing the securities laws, this Court has considered several factors—the statutory language, the legislative history, the statutory scheme, and public policy considerations.[5] In the present case, those factors lead to the conclusion that the certificate of deposit here at issue is not a security subject to the antifraud provisions.

A. The Language of the Statutory Definition Requires Consideration of the Special Regulatory Context of this Case

1. " 'The starting point in every case involving construction of a statute is the language itself.' " *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979), quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). While the term "security" is broadly defined in both Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), and Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10), to include both equity and debt instruments,[6] that definition, like the other definitions, is qualified by the prefatory expression "unless the context otherwise requires * * *." Section 2 of the Securities Act, 15 U.S.C. 77b; Section 3(a) of the Securities Exchange Act, 15 U.S.C. 78c(a). As this Court has

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[5] See, *e.g.*, *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979); *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976).

[6] Congress chose to define " 'the term security in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.' " *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 847-848 (1975), quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933).

recognized, "[t]he task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes." *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 848 (1975).

The Senate bill and original version of the House bill that later became the Securities Act of 1933 contained the prefatory expression "unless the *text* otherwise indicates." S. 875, 73d Cong., 1st Sess. § 2 (1933); H.R. 4314, 73d Cong., 1st Sess. § 2 (1933) (emphasis added). A later House version of the bill substituted the broader language "unless the *context* otherwise requires." H.R. 5480, 73d Cong., 1st Sess. § 2 (1933) (emphasis added). After passage of the bill by the House and Senate, the House version of the introductory language was adopted in conference and enacted into law. Ch. 38, Section 2, 48 Stat. 74. This same language was included verbatim in each of the securities statutes that later were enacted.[7] The word "context," which Congress deliberately selected, refers to "the surrounding factual circumstances." See, *e.g.*, *Emisco Industries, Inc.* v. *Pro's, Inc.*, 543 F.2d 38, 39 (7th Cir. 1976); accord, *Exchange National Bank* v. *Touche Ross & Co.*, 544 F.2d 1126, 1137-1138 (2d Cir. 1976).[8]

Consistent with Congress' focus on the context of a transaction, this Court's decisions construing the term "security" have held that

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[7] See Section 3(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a); Section 2(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79b(a); Section 303 of the Trust Indenture Act of 1939, 15 U.S.C. 77ccc; Section 2(a) of the Investment Company Act of 1940, 15 U.S.C. (& Supp. III) 80a-2(a); Section 202(a) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a).

[8] The word "context" denotes "the interrelated conditions in which something exists or occurs," "environment," or "surroundings." *Webster's Third New International Dictionary* 492 (1976).

> courts will construe the details of an act in conformity with its dominating general purpose, will read the text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

SEC v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943).[9] Other decisions of this Court, although not expressly relying on the prefatory language, have utilized this same approach. See, *e.g.*, *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967):

> [I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality.

See also *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 558; *United Housing Foundation, Inc.* v. *Forman*, *supra*, 421 U.S. at 848-849 (noting that "a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers").[10]

The rules of construction that are relevant in this case therefore are sufficiently clear. The starting place is the language of the statute itself. If, however, the context of a given transaction so "requires," a literal application of the statutory definition should be subordinated to

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[9] See also *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969).

[10] Although this Court in *Forman* declined to follow a literal approach, the opinion made clear that the name of an instrument is not "wholly irrelevant" to a determination whether the instrument is a security. The Court emphasized that "[t]here may be occasions when the use of a traditional name such as 'stocks' or 'bonds' will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument." The Court added that "most instruments bearing these traditional titles are likely to be covered by the statutes." 421 U.S at 850-851.

Congress' underlying intent. Effectuation of the intention of the legislature remains the touchstone.[11]

2. Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10), defines the term "security" to include any "note" or "debenture." Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), which this Court has construed as being "virtually identical to that contained in the 1934 Act,"[12] defines the term "security" also to include any "evidence of indebtedness." Although the certificate of deposit issued by Marine Bank could be found to fall within this definitional language,[13] the presumption that a security exists may be rebutted by establishing that the "context otherwise requires." *Exchange National Bank* v. *Touche Ross & Co., supra,* 544 F.2d at 1137-1138. In analyzing that issue, it is necessary to go beyond the statutory language and to consider the special regulatory environment in which the instrument was issued. In this connection, it is highly signif-

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[11] We do not suggest that in all cases federal courts need sift the circumstances surrounding a transaction to form an ad hoc opinion on whether the transaction is subject to the federal securities laws. The comprehensive and carefully prescribed definitions in the securities laws ordinarily apply at face value, and generally are themselves a safe guide to congressional intent. See *SEC* v. *C.M. Joiner Leasing Corp., supra,* 320 U.S. at 351; *Tcherepnin* v. *Knight, supra,* 389 U.S. at 339; *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. at 850. As Judge Friendly emphasized in *Exchange National Bank* v. *Touche Ross & Co., supra,* 544 F.2d at 1137-1138, Congress has provided an exception from the literal terms of its definitions when the context so *requires.* The need to look beyond the statutory definitional language arises only in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute.

[12] *Tcherepnin* v. *Knight, supra,* 389 U.S. at 336. See also *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. at 847 n.12.

[13] As in the case of notes, debentures, and evidences of indebtedness generally, certificates of deposit represent a transaction in which the use of money is obtained in exchange for a promise to pay interest and to repay a fixed sum at a future date.

icant that the certificate of deposit was issued by a federally regulated bank.

In contrast to the federal securities laws, which through disclosure of material facts enable investors to make an "informed choice" among investments, including an assessment of the risk involved, the regulation of the banking industry, like that of the insurance industry, emphasizes pervasive governmental supervision to substantially eliminate the risk of loss. See *SEC* v. *Variable Annuity Life Insurance Company*, 359 U.S. 65, 77 (1959) (Brennan, J., concurring). Under the federal bank regulatory scheme, almost all phases of the business of national, state member, and insured state non-member banks are regulated at the federal level.[14] The Board of Governors regulates state chartered banks that are members of the Federal Reserve System. 12 U.S.C. 241 *et seq.* The Comptroller is charged with the administration of the national banking system and the regulation of all national banks. See 12 U.S.C. 1 *et seq.* The FDIC insures the deposits of all national banks, all state banks that are members of the Federal Reserve System, and all state non-member banks that have qualified for and obtained federal deposit insurance. In addition, the FDIC supervises, in conjunction with state banking agencies, insured state banks that are not members of the Federal Reserve System. 12 U.S.C. (& Supp. III) 1811 *et seq.*

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[14] As one informed commentator has observed, "[t]he regulation of banking may be more intensive than the regulation of any other industry, and it is the oldest system of economic regulation. The system may be one of the most successful, if not the most successful. The regulation extends to all major steps in the establishment and development of a national bank, including not only entry into the business, changes in status, consolidations, reorganizations, but also the most intensive supervision of operations through regular examination of banks." K. Davis, *Administrative Law Treatise* § 4.04 at 247 (1958). See also *Fahey* v. *Mallonee*, 332 U.S. 245, 250 (1947) ("Banking is one of the longest regulated and most closely supervised of public callings").

Federal standards are set for entry into the banking industry through the authority of the Comptroller to issue charters to national banks and the authority of the FDIC to deny federal deposit insurance to state banks that fail to meet specified criteria.[15] Banks also are subject to reserve,[16] reporting,[17] and inspection[18] requirements, which are designed to assure financial soundness. In addition, banking regulation places limits on advertising by banks with respect to the description of interest

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[15] 12 U.S.C. (& Supp. III) 27 (national banks); 12 U.S.C. 322 (state member banks). The FDIC has considerable authority over the entry of banks into the deposit receiving business. All national and state member banks must be insured; the Comptroller and the Board of Governors certify to the FDIC that a bank meets prescribed standards before insurance will be provided. 12 U.S.C. 1814. Although states are empowered to issue charters, the attractiveness of federal deposit insurance gives the FDIC the ability to influence the grant of charters to state non-member banks. Several of the nation's largest states require that the deposits of banks they charter be insured by the FDIC. See, *e.g.*, N.Y. Banking Law § 32 (McKinney Supp. 1980-1981); Pa. Stat. Ann. tit. 7, § 105(a) (Purdon Supp. 1981-1982); Cal. Administrative Register of the Superintendent of Banks 79, No. 2-B §§ 10.139, 10.3520 (Jan. 13, 1979).

[16] 12 U.S.C. 461(b), as amended by Pub. L. No. 96-221, Section 103, 94 Stat. 133-138; see also Board of Governors, *Reserve Requirements of Depository Institutions: Regulation D* § 204.5 (1980), as amended by 45 Fed. Reg. 56022 (1980) and 46 Fed. Reg. 10140 (1981) (to be codified at 12 C.F.R. 204.3) (national banks, state member banks and state non-member banks).

[17] 12 U.S.C. 161 (national banks); 12 U.S.C. 324 (state member banks); 12 U.S.C. (& Supp. III) 1817 (state non-member insured banks).

[18] 12 U.S.C. 481 (national banks); 12 U.S.C. 483 (member banks); 12 U.S.C. (& Supp. III) 1820(b) (state non-member insured banks). Federal banking agencies fulfill their regulatory responsibilities primarily through on-site examinations of the banks they supervise, with follow-up supervision for correction of any detected deficiencies or violations of law. When instruction are not followed or when further action is deemed necessary for any other reason, the banking agencies may initiate formal administrative cease and desist proceedings and may remove dishonest management. See 12 U.S.C. (& Supp. III) 1818.

paid on deposits,[19] including a broad prohibition of any advertisement by a bank "which is inaccurate or misleading or which misrepresents its deposit contracts." [20]

Banks are exempt from coverage under the Federal Bankruptcy Act and instead are subject to special rules governing bank insolvencies. 11 U.S.C. 22; 11 U.S.C. (Supp. III) 109(b)(2). In the case of national banks, the Comptroller is charged with determining when a bank is insolvent and when it is necessary to appoint a conservator. 12 U.S.C. 191 *et seq.*, 201 *et seq.* If the chartering authority determines to close a bank, the FDIC is required to pay the depositors the amount of their insured deposits. 12 U.S.C. 1821(f). In lieu of this procedure, the FDIC may make loans to, purchase the assets of, or make deposits in a distressed bank or take other measures to minimize potential losses, including arranging a merger of the distressed bank with another insured bank. See 12 U.S.C. 1823(c), (e). By use of this authority, the banking agencies can achieve repayment of virtually all the monies owed to a bank's depositors and other creditors.[21]

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[19] 12 C.F.R. 217.6 (member banks); 12 C.F.R. 329.8 (insured state non-member banks). See *FDIC* v. *Sumner Financial Corporation*, 451 F.2d 898, 900-905 (5th Cir. 1972).

[20] 12 C.F.R. 217.6(g); 12 C.F.R. 329.8(f).

[21] Since the formation of the FDIC in 1933, 568 insured banks have been closed. Of that number 310 have had their insured deposits paid off and 258 have, with the financial assistance of the FDIC, been merged with or sold to other insured banks. In addition, five banks have received direct loans from the FDIC. With respect to the 568 federally insured banks that were closed as of year-end 1980, 99.9% of the depositors actually received or were assured payment of their deposits in full and 99.8% of the total deposits were paid or made available. While recovery of uninsured portions of deposits may vary, an aggregate of nearly 97.3% of uninsured deposits had been paid or made available in the 310 pay-off cases as of year-end 1980. In those same cases, 99.2% of the depositors received payment in full. In the 258 purchase and assumption cases, all depositors were fully protected. All depositors were fully protected in the five cases involving direct assistance from the FDIC. *1980 Annual Report of the FDIC* 18-21 (1981).

The primary purpose for applying the antifraud provisions of the federal securities laws to certificates of deposit would be to protect bank depositors against deception regarding the likelihood of repayment of principal and interest. While crucial for the protection of investors in most situations, the need for this safeguard is minimized when the instruments being purchased by the public are certificates of deposit issued by banks subject to a comprehensive scheme of federal regulation that substantially eliminates the risk of non-payment of principal and interest.

The extensive controls over the business operations of banks are not intended to provide protection against ordinary investment risk for the purchasers of a bank's common stock, whose financial interests depend on the profitability of the bank's operations. However, they do extend effective protection to bank depositors, whose financial interests are limited to repayment of their principal together with a fixed dollar return. As pointed out in the dissenting opinion in the court of appeals (Pet. App. A-21):

> [B]ank borrowing and lending activities are closely regulated by designated governmental agencies. Because of this supervision, the need to protect depositors under the Securities Exchange Act is not as apparent as it is with nonbanking entities.

See also *Ayala* v. *Jamaica Savings Bank*, [1981] Fed. Sec. L. Rep. ¶ 98,041 (CCH) (E.D.N.Y. June 15, 1981).

Finally, and of particular pertinence here (see note 41, *infra*), the federal banking agencies possess express statutory authority to protect bank customers, including depositors, against any "unfair or deceptive acts or practices * * * (including acts or practices which are unfair or deceptive to consumers)" that may be committed by federally regulated banks. 15 U.S.C. (& Supp. III) 57a (f). Each bank regulatory agency is authorized to receive complaints from aggrieved bank customers and "to take appropriate action upon complaints with respect to acts or practices by banks subject to its jurisdiction."

Ibid. See also 41 Fed. Reg. 44361-44362 (1976); 12 C.F.R. 227.2. This authority may be implemented under 12 U.S.C. (& Supp. III) 1818(b), which permits the bank regulatory agencies to rectify any "unsafe or unsound practice," or any violation of "law, rule, or regulation," through a "cease and desist order" that may, by "mandatory" terms or otherwise, require the bank to "take affirmative action to correct the conditions resulting from any such violation or practice." *Ibid.* See also 45 Fed. Reg. 48712 (1980) (discussing remedial powers of bank regulatory agencies in Truth in Lending Act cases).[22]

In view of the presence of comprehensive safeguards for depositors provided by the bank regulatory agencies, the language of the securities laws—which requires attention to context—supports the conclusion that the certificate of deposit issued by petitioner is not a security subject to the antifraud provisions.

B. The Legislative History and Statutory Scheme Show that Congress Did Not Intend the Antifraud Provisions To Apply to Deposit Transactions by Federally Regulated Banks

The conclusion that the antifraud provisions do not apply to deposit transactions is supported by an examination of the relevant legislative history and the statutory scheme. That examination shows that Congress intended that the deposit transactions of banks would be governed by the banking statutes rather than the securities laws.

1. In March 1933, President Roosevelt sent to Congress the bill that later was to become the Securities Act. At that time, he expressed the view that bank

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[22] In addition to their formal enforcement authority, each of the agencies provides an informal mechanism through a division of consumer affairs to resolve disputes between banks and their customers involving alleged deceptive or unfair practices. Complaints are typically resolved informally. In some instances, however, the banks involved are directed or formally ordered to take corrective action.

regulation should be embodied in separate legislation. See 77 Cong. Rec. 937 (1933). Shortly after the President sent his message to Congress, the Senate passed a resolution that authorized the Senate Committee on Banking and Currency to continue its investigation of the practices of companies engaged in "the business of banking" and companies engaged in the securities business. S. Res. 56, 73d Cong., 1st Sess. (1933). As a result of these and earlier investigations, Congress enacted the Securities Act of 1933, 15 U.S.C. 77a *et seq.*, the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, and the Banking Act of 1933 (commonly known as the "Glass-Steagall Act").[23] See S. Rep. No. 1455, 73d Cong., 2d Sess. 1-4 (1934). While the securities acts primarily were concerned with the interests of investors,[24] the Glass-Steagall Act focused on the interests of depositors and provided a comprehensive scheme of regulation over many aspects of the operation and management of banking institutions.[25]

The fact that Congress enacted a separate comprehensive scheme of legislation to govern bank deposits is most significant in determining whether Congress intended that the deposit transactions of banks also would be subject to regulation under the federal securities laws. See *Radzanower* v. *Touche Ross & Co.*, 426 U.S. 148,

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[23] The Glass-Steagall Act included the original Federal Deposit Insurance Act. The provisions of the Glass-Steagall Act, ch. 89, 48 Stat. 162, are codified in various sections of Title 12 of the United States Code. While the Glass-Steagall Act uses the term "securities" in various provisions, the meaning of that term as used in Glass-Steagall is not raised by this case.

[24] See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194-195 (1976).

[25] As this Court recently stated in *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, No. 79-927 (Feb. 24, 1981), slip op. 14: "It is familiar history that the Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression."

157 (1976).[26] The situation here is comparable to that in *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 569-570. In *Daniel*, this Court found that the prescription by Congress, 40 years after enactment of the federal securities laws, of a comprehensive scheme of legislation governing employee benefit plans provided evidence that an interest in a non-contributory, compulsory pension plan was not a security. The fact that Congress simultaneously enacted two separate regulatory schemes to correct abuses in the securities and banking industries is *a fortiori* evidence of Congress' intent to regulate the deposit business of banks through the banking statutes, not the federal securities laws. See *Ayala* v. *Jamaica Savings Bank*, [1981] Fed. Sec. L. Rep. ¶ 98,041 (CCH) (E.D.N.Y. June 15, 1981).

2. Moreover, the legislative history of the securities laws affirmatively shows that Congress did not intend that deposit instruments issued by commercial banks would be deemed to be securities. At the House hearings, in response to a question from Representative Mapes relating to the coverage of proposed Section 3(a)(2) of the Securities Act, 15 U.S.C. 77c(a)(2), which exempts bank securities from the registration provisions of the Securities Act, Huston Thompson, one of the draftsmen of the bill under consideration, explained that while the bill would encompass "any kind of a security of a national bank," he did "not suppose a national bank would be putting out anything in addition to its capital stock." [27]

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[26] The Court noted in *Radzanower* that, "[w]hile Congress did examine problems stemming from the relationship of banks and the securities business in the early 1930's, * * * it dealt with those problems in comprehensive legislation dealing only with banks." 426 U.S. at 155 n.11. The Court added: "The passage of that legislation * * * suggest[s], if anything, that Congress was reaffirming its view that national banks should be regulated separately by specific legislation applying only to them." *Id.* at 157.

[27] *Federal Securities Act: Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 31 (1933).

Similarly, there is evidence that, in considering the bill that became the Securities Exchange Act, Congress viewed the economic interests of depositors as being distinct from those of investors. It was the interest of investors that required special protection under the securities laws. During the Senate hearings, Senator Adams, a member of the Banking and Currency Committee, and Albert H. Wiggin, a witness and former banker, emphasized that safety of principal was far less a problem for depositors than investors:

> Senator Adams. I am just wondering if, perhaps, this conclusion might be drawn * * *—that the only man, during this period of financial stress who was fortunate, was the man who had money on deposit in a good bank.
>
> Mr. Wiggin. You are entirely right, Senator. The man who had any investments saw the value of those investments shrink, and shrink, and shrink. The man who kept his cash, and had it in a good bank, had no shrinkage.
>
> * * * * *
>
> Yes. It is hard to compare the depositors in the bank with the others.[28]

Thus, investors and depositors were viewed as standing in fundamentally different positions:

> Senator Adams. I saw in some statistics that I was reading the other day that in the closed banks in this country the depositor has ultimately received nearly 70 percent of his money out of the closed banks, and I gather that the stockholder in an open bank has seen his stock shrink from 600 to 125. In other words, the depositor in the closed bank is in

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[28] *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 56 Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 2426-2427 (1934).

a more fortunate position than the stockholder in the open bank, on the average.[29]

3. The relevant legislative history and statutory scheme distinguish this case from *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967). In *Tcherepnin*, this Court held that withdrawable capital shares in a state-chartered savings and loan association, as to which payment of dividends was dependent on the profits of the association, were securities subject to the antifraud provisions of the Securities Exchange Act. As the Court observed, the instrument at issue "fit well within several * * * descriptive terms contained in § 3(a)(10)" of that Act (389 U.S. at 339), and the conclusion that it was a security was "reinforced by the legislative history of federal securities legislation." *Id.* at 340. *Tcherepnin* relied in part on express legislative history indicating that Congress specifically examined the need for application of the antifraud provisions to "capital shares" of savings and loan associations. In contrast, the legislative history affirmatively demonstrates that Congress intended that the deposit transactions of banks would be subject to regulation under the federal banking laws, not the federal securities laws.[30] Moreover, in contrast

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[29] *Id.* at 2426-2427. Congress' view that the interests of investors are fundamentally different from those of depositors is also demonstrated by the fact that, while Congress afforded depositors substantial protection through insurance, no such guarantees were afforded investors. See 77 Cong. Rec. 937 (1933) (President's Message).

[30] Of course, in instances unlike this case in which Congress may merely have failed to recognize or anticipate that a particular instrument would fall within the statutory definition, that failure would have little relevance. "[I]f Congress has made a choice of language which fairly brings a given situation within a statute, it is unimportant that the particular application may not have been contemplated by the legislators." *Barr* v. *United States*, 324 U.S. 83, 90 (1945). See also *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 299 (1946) (the term "investment contract" "embodies a flexible rather than a static principle, one that is capable of adaptation to meet * * * countless and variable schemes").

to federally regulated banks, the state-chartered savings and loan association involved in *Tcherepnin* was not subject to the safeguards of a comprehensive federal regulatory scheme.[31] Accordingly, this Court correctly ruled that the purposes of the federal securities laws would be served by affording protection to the class of persons who invested their money in the association. See ALI, *Federal Securities Code* § 202(150), Comment 7(b) (last sentence) (1980).

4. The conclusion that the certificate of deposit issued by Marine Bank is not a security results in an interpretation of the term "security" that is consistent with the statutory schemes of the federal securities and banking laws.[32] The foregoing analysis, however, may not neces-

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[31] The savings and loan association had been denied federal insurance of its accounts precisely because of its unsafe financial policies. *Tcherepnin* v. *Knight, supra,* 389 U.S. at 334.

[32] The lower courts generally have held that certificates of deposit issued by federally regulated banks are not securities. *Ayala* v. *Jamaican Savings Bank,* [1981] Fed. Sec. L. Rep. ¶ 98,041 (CCH) (E.D.N.Y. June 15, 1981) (Securities Act and Securities Exchange Act); *Drovers Bank* v. *SFC Corporation,* 452 F. Supp. 580, 582 (N.D. Ill. 1978) (Investment Company Act of 1940); see *Bellah* v. *First National Bank,* 495 F.2d 1109, 1116 (5th Cir. 1974) (Securities Exchange Act); *SEC* v. *Fifth Avenue Coach Lines, Inc.,* 289 F. Supp. 3, 31-33 (S.D.N.Y. 1968), aff'd, 435 F.2d 510 (2d Cir. 1970) (Investment Company Act). But see *Young* v. *Seaboard Corp.,* 360 F. Supp. 490, 495-496 (D. Utah 1973) (Securities Exchange Act). See generally *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 300 F. Supp. 1083, 1100 (S.D.N.Y. 1969) (dictum) (Securities Act and Securities Exchange Act), aff'd, 430 F.2d 355 (2d Cir. 1970), rev'd on other grounds, 404 U.S. 6 (1971).

With respect to certificates of deposit or similar instruments issued by institutions that are not federally regulated, the lower courts are divided. Compare *SEC* v. *First American Bank and Trust Company,* 481 F.2d 673, 677 (8th Cir. 1973) (certificates of investment and savings accounts of state banking institution are securities under Securities Act); *MacKethan* v. *Peat, Marwick, Mitchell & Co.,* 439 F. Supp. 1090, 1093-1094 (E.D. Va. 1977) (certificates of investment of state industrial loan association may

sarily apply in other contexts. The better reasoned decisions of the lower courts do not view the question whether a certificate of deposit is a security in the abstract, or in light of the labels attached to a given instrument, but instead turn to a careful consideration of the context. For example, in *Canadian Imperial Bank of Commerce Trust Company* v. *Fingland*, 615 F.2d 465, 470 (7th Cir. 1980), the court explained (emphasis in original):

> We have been cautious not to say that *any* document called a certificate of deposit cannot be a security. The definitional provision begins with the words 'unless the context otherwise requires' and if a victim can adequately plead in non-conclusory allegations showing the context, substance and reality surrounding the sale or purchase of a particular investment, he may well succeed.[33]

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be securities under Securities Act and Securities Exchange Act); *Garner* v. *Pearson*, 374 F. Supp. 591, 596 (M.D. Fla. 1974) (certificates of deposit of Bahamian bank are securities under Securities Exchange Act) with *Canadian Imperial Bank of Commerce Trust Company* v. *Fingland*, 615 F.2d 465, 470 (7th Cir. 1980) (complaint insufficient to establish that certificates of deposit of Bahamian bank are securities under Securities Exchange Act); *Hendrickson* v. *Buchbinder*, 465 F. Supp. 1250, 1254 (S.D. Fla. 1979) (passbooks/certificates of deposit of Bahamian banking entities are not securities under Securities Exchange Act); *Hamblett* v. *Board of Savings and Loan Associations*, 472 F. Supp. 158, 166 (N.D. Miss. 1979) (certificates of deposit, savings certificates and passbooks of state savings and loan are not securities under Securities Act and Securities Exchange Act). See generally *Burrus, Cootes and Burrus* v. *MacKethan*, 537 F.2d 1262, 1265 (4th Cir.) (certificates of investment of state industrial loan corporation are not securities under Securities Exchange Act), opinion withdrawn and prior judgment aff'd on other grounds, 545 F.2d 1388 (1976), cert. denied, 434 U.S. 826 (1977).

[33] Similarly, the Fifth Circuit has recognized that "it may be true that in certain situations a certificate of deposit can be a security as that term is used in the [Securities Exchange] Act * * *." *Reid* v. *Hughes*, 578 F.2d 634, 638 (1978). See also *Bellah* v. *First National Bank, supra*, 495 F.2d at 1109, 1114 & n.6; *Adato* v. *Kagan*, 599 F.2d 1111, 1116 n.5 (2d Cir. 1979).

One context in which a different result might be appropriate is the issuance of certificates of deposit by bank-type entities that are not regulated. The SEC believes that, in such situations, bank-type institutions should not be treated differently than other business corporations that seek capital to conduct business operations through the sale of interest bearing debt obligations.[34]

The Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, also presents a significantly different context. As of May 1981, money market funds registered with the SEC under the Investment Company Act held assets in excess of $118 billion, with approximately 22.9% of those assets invested in domestic certificates of deposit.[35] Money market funds fall within the definition of "investment company" prescribed in Section 3(a)(1) of the Investment Company Act, 15 U.S.C. 80a-3(a)(1), and therefore are subject to regulation under that Act if they are "engage[d] primarily, in the business of investing, reinvesting, or trading in securities."[36] While the lan-

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[34] The SEC has brought enforcement actions against financial institutions that publicly issue debt instruments similar to certificates of deposit, but that are not subject to the comprehensive regulatory scheme provided by federal banking legislation. See, *e.g.*, *SEC* v. *Meek*, Civ. No. 81-227-T) (W.D. Okla.) Lit. Release No. 9391 (July 9, 1981), 23 S.E.C. Docket 75 (state trust company issuing uninsured certificates of deposit and passbook savings accounts); *SEC* v. *Liberty Loan Corporation*, Civ. No. 76-304c (E.D. Mo.) Lit. Release No. 7356 (Apr. 13, 1976), 9 S.E.C. Docket 446 (Morris Plan companies issuing "thrift certificates"); *SEC* v. *Town Enterprises, Inc.*, Civ. No. 75-85 (D. Del.), Lit. Rel. No. 6850 (Apr. 23, 1975), 6 S.E.C. Docket 740 (Morris Plan companies issuing "term investment certificates"); *SEC* v. *First American Bank & Trust Company*, 481 F.2d 673 (8th Cir. 1973) state banking institution issuing "certificates of investment").

[35] See *Donoghue's Money Fund Report* (May 4, 1981).

[36] Money market funds may also be considered investment companies under Section 3(a)(3) of the Act, 15 U.S.C. 80a-3(a)(3).

guage in the Investment Company Act's definition of the term "security" is identical to that in the Securities Act,[37] the regulatory context under the Investment Company Act differs fundamentally from that under the Securities Act and the Securities Exchange Act. The Investment Company Act broadly regulates the operation and management of investment companies.[38] Because the relationship between a money market fund and its shareholders is identical to the relationship between any other investment company and its shareholders, and because the assets of both investment media are highly liquid and are subject to external management, investor protection requires that money market funds continue to be regulated under the Investment Company Act. Since the bank regulatory statutes generally do not apply to the operation of these funds, and since the exclusion of cer-

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[37] See Section 2(a)(36) of the Investment Company Act, 15 U.S.C. 80a-2(a)(35).

[38] That Act prescribes important provisions regulating the valuation of assets (15 U.S.C. 80a-2(a)(41)(B), 17 C.F.R. 270.2a-4), the presence of disinterested directors (15 U.S.C. 80a-10(a)), the performance of fiduciary duty (15 U.S.C. 80a-35), the compensation of the funds' investment advisers (15 U.S.C. 80a-15(a)), the safekeeping of assets and bonding (15 U.S.C. 80a-17(f)), and company transactions with affiliates (15 U.S.C. 80a-17(a), 80a-17(d), and 80a-17(e)). See generally, *Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission on the Regulation of Money Market Funds Before the Senate Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. (1981).

The SEC recently settled three administrative proceedings involving money market funds and affiliated persons and has commenced proceedings against others. See *Government Securities Management Co. and Fundlink Information Services*, Investment Company Act Release No. 11583, 21 S.E.C. Docket 1495 (Jan. 26, 1981); *Reserve Management Corporation*, Investment Company Act Release No. 11394, 21 S.E.C. Docket 190 (Oct. 10, 1980); *Paul Buchbaum & S. Jay Levy*, Investment Company Act Release No. 11065, 19 S.E.C. Docket 805 (Mar. 4, 1980); *First Multifund Advisory Corp.*, Investment Company Act Release No. 11064, 19 S.E.C. Docket 804 (Mar. 4, 1980).

tificates of deposit from the definition of security in the Investment Company Act would seriously undermine the protections contemplated by Congress, the SEC believes that the relevant context requires that the term "security" take on a "different coloration" under the Investment Company Act. See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969) (holding that "[t]he meaning of particular phrases must be determined in context," and that the term "sale" has a "different coloration" under the registration provisions of the Securities Act than under the antifraud provisions of the Securities Exchange Act because the "context otherwise requires").[39]

To avoid foreclosing the foregoing issues,[40] we respectfully urge the Court to limit its focus to the applicability of the antifraud provisions of the Securities Act and the Securities Exchange Act to the facts of this case. The Court should make it clear that its decision does not resolve the question whether the federal securities laws are applicable in other contexts involving certificates of deposit.

C. Redundant Regulation that Provides No Substantial Public Benefit Should Be Avoided

Application of the antifraud provisions to certificates of deposit issued by federally regulated banks would mean that an industry that already is subject to pervasive regulation to protect depositors would be subject to

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[39] See also *Steadman* v. *SEC*, No. 79-1266 (Feb. 25, 1981), slip op. 8 (holding that "in view of the entirely different purposes of § 7(c) and § 10(e) [of the Administrative Procedure Act] * * *" the words "substantial evidence" appearing in both sections are given "different meanings in context"). Although the American Law Institute's *Federal Securities Code* would exclude from the definition of security a certificate of deposit issued by a regulated bank, that exclusion would not apply under the provisions of the Code governing investment companies. See ALI, *Federal Securities Code* § 202(150)(B)(v) (1980).

[40] Another situation that may present a different context is the trading of certificates of deposit in the secondary market, a circumstance that is not presented in this case.

regulation under another federal scheme. The antifraud provisions would bring into play the investigative and enforcement authority of the SEC, including its authority to subpoena records, take testimony, and commence enforcement actions seeking disclosure and other injunctive relief. See Sections 19(b) and 20(b) of the Securities Act, 15 U.S.C. 77s(b) and 77t(b); Section 21 of the Securities Exchange Act of 1934, 15 U.S.C. 78u; *Aaron* v. *SEC*, 446 U.S. 680 (1980).

The two schemes of regulation—banking regulation and securities regulation—have different orientations. The federal bank regulatory agencies have effectively protected depositors while maintaining necessary confidentiality of bank operations. Indeed, in certain cases, such confidentiality may be essential to maintain the financial integrity of banks and to preserve public trust in the banking system. Application of the antifraud provisions, with their emphasis on disclosure, could, in the view of the bank regulatory agencies, interfere with the federal scheme of bank regulation prescribed by Congress and impose unwarranted costs on banks and their customers.

As this Court recognized in *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 569-570, sound principles of statutory construction require the avoidance of unnecessary and potentially inconsistent overlap in the regulatory jurisdiction of federal agencies. In reaching the conclusion in *Daniel* that an employee's interest in a noncontributory, compulsory pension plan is not a security, this Court noted that the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 1001 *et seq.*, unlike the federal securities laws, "deals expressly and in detail with pension plans." 439 U.S. at 569. In particular, the Court recognized that ERISA requires pension plans to disclose specified information and regulates the substantive terms of pension plans. *Id.* at 569-570. Similarly, the certificate of deposit at issue in this case was issued by a bank subject to comprehensive regu-

lation to assure honesty in its dealing in such certificates and the continuing financial stability of the issuer. In light of those protections, application of the antifraud provisions "serves no general purpose" (*id.* at 570) and would defeat Congress' intent to remove from the scope of the securities laws those "types of securities and securities transactions where there is no practical need for [the statutes'] application or where the public benefits are too remote." H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933). See *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 41 (1977).[41]

II. THE LOAN GUARANTEE AGREEMENT INVOLVED IN THIS CASE IS NOT A SECURITY WITHIN THE MEANING OF THE FEDERAL SECURITIES LAWS

The court of appeals also held (Pet. App. A-5 to A-9) that the loan guarantee agreement between the Weavers and the Piccirillos could constitute a "certificate of interest or participation in any profit-sharing agreement" or an "investment contract." This Court need not, however, decide whether the agreement can be so classified. Regardless of the literal applicability of the statutory terms relied on by the court of appeals, the "context" of this case "requires" that the agreement not be treated as a security.

This Court's decisions establish that, while "most instruments bearing these traditional titles [the titles included within the statutory definitions of security] are likely to be covered by the statutes" (*United Housing Foundation, Inc.* v. *Forman, supra*, 421 U.S. at 850), unusual cases may arise in which inflexible application

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[41] Cases of alleged bank fraud that do not involve securities, such as the present case, are properly cognizable in state court (see generally *Santa Fe Industries, Inc.* v. *Green, supra*, 430 U.S. at 478) or before the banking agencies under statutory provisions such as 15 U.S.C. (& Supp. III) 57a(f) (see pages 14-15, *supra*).

of the statutory definition would be contrary to Congress' intent. This is particularly true when instruments are created in primarily consumer or mercantile contexts, not involving a public distribution. Thus, this Court has stated that "'[t]he test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.'" *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967), quoting *SEC* v. *C. M. Joiner Leasing Corp.*, *supra*, 320 U.S. at 352-353.

For example, in *Forman* this Court concluded that shares of stock issued by a housing cooperative were not securities even though the statutory definition literally encompassed all species of "stock." The Court noted that the plaintiffs were induced to purchase the stock "solely to acquire subsidized low-cost living space" and not to "invest for profit" (421 U.S. at 851). The lower courts have faced comparable complexities in construing the term "note" appearing in the statutory definitions of "security." Many notes are investment vehicles properly subject to the antifraud provisions of the federal securities laws. On the other hand, the lower courts repeatedly have refused to apply the term "note" in a literal manner to encompass promissory notes issued by individuals to banks, notes given in consumer installment transactions, or short term commercial notes secured by accounts receivable. Although the courts have not arrived at a consensus in specifying the governing criteria,[42] they are

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[42] For example, the Fifth, Seventh and Tenth Circuits rely on a dichotomy between "investment" and "commercial" transactions. See, *e.g.*, *Williamson* v. *Tucker*, 645 F.2d 404, 426-429 (5th Cir. 1981); *Bellah* v. *First National Bank*, *supra*, 495 F.2d at 1111-1114; *Zabriskie* v. *Lewis*, 507 F.2d 546, 550-552 (10th Cir. 1974); *Emisco Industries, Inc.* v. *Pro's, Inc.*, *supra*, 543 F.2d at 39-41. The Ninth Circuit examines a transaction's context to determine whether it is properly viewed as a "risk capital" transaction. See, *e.g.*, *Amfac Mortgage Corp.* v. *Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431-432 (1978). The Second Circuit, in contrast,

united in their willingness to examine the "context" of a transaction that, although falling within the literal terms of the statutory definition, does not appear to come within the intent of the drafters.[43] This inquiry has been motivated by the concern expressed by the Fifth Circuit in *Bellah* v. *First National Bank*, 495 F.2d 1109, 1114 (5th Cir. 1974): "We doubt that Congress intended by these Acts to render federal judges the guardians of all beguiled makers or payees."

Among the factors that courts have considered in determining whether a particular note could reasonably be viewed as an investment subject to the protections Congress afforded under the federal securities laws are: (1) the number of instruments issued and the number and nature of the payees; (2) the existence of underwriting or promotional activity; (3) the manner in which the instruments are characterized in the business community; (4) the manner in which the proceeds are used; and (5) the length of time to maturity. See, *e.g.*, *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1361-1362 (7th Cir.), cert. denied, 423 U.S. 825 (1975); *McClure* v. *First National Bank*, 497 F.2d 490, 493-494

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begins with a presumption that the statute encompasses any note, but recognizes exceptions for note transactions bearing a "family resemblance" to consumer and mercantile transactions. See *Exchange National Bank* v. *Touche Ross & Co.*, *supra*, 544 F.2d at 1137-1138. The authorities are discussed in Sonnenschein, *Federal Securities Laws Coverage of Note Transactions: The Antifraud Provisions*, 35 Bus. Law. 1567 (1980). The American Law Institute's *Federal Securities Code* § 202(150)(B)(iii) and Comment 6 (1980) excludes from the definition of security "a note or evidence of indebtedness issued in a primarily mercantile or consumer, rather than investment, transaction not involving a distribution." The Comment describes this formulation as a codification of the emerging principle and as "the least imperfect solution to a troublesome problem."

[43] See *United Housing Foundation, Inc.* v. *Forman*, *supra*, 421 U.S. at 849 n.14 (referring with approval to lower court decisions declining to follow a literal approach in applying the term "note").

(5th Cir. 1974), cert. denied, 420 U.S. 930 (1975).[44] While we do not endorse all of the discussion appearing in the lower court decisions,[45] we agree that their focus on "context" in doubtful cases is consistent with the "economic realities" criterion announced in this Court's opinions.[46]

On its face, the Weavers' loan guarantee agreement has few characteristics ordinarily associated with a security. And examination of the "context" confirms that view. The economic substance of the agreement was that the Weavers assisted their neighbors in obtaining a loan from a commercial bank.[47] They received in return a combination of cash and non-cash benefits uniquely suited to their business needs. The loan in question was a demand loan (Pet. App. A-3). The proceeds of the loan were used not for the acquisition of capital assets but for payment of past due bank loans, taxes, and debts owing to trade creditors, as well as for general "working capital" (*ibid.*). Unlike the ordinary security holder who receives dividends or interest, the Weavers obtained use of the Piccirillos' barn and pasture, subject to the Piccirillos' discretion (*id.* at A-15). While the Weavers were entitled to receive certain cash payments and a portion of any profits of the business, those benefits were to last

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[44] Of course, the securities laws do "not stop with the obvious and commonplace." In appropriate cases, "[n]ovel, uncommon, or irregular devices" may be reached under the antifraud rules. *SEC* v. *C. M. Joiner Leasing Corp.*, *supra*, 320 U.S. at 351. "And the fact that the transaction is not conducted through a securities exchange or an organized over-the-counter market is irrelevant to the coverage of § 10(b)." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 10 (1971).

[45] We are mindful of this Court's warning in *SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 465, that questions such as these "arise in an area where glib generalizations and unthinking abstractions are major occupational hazards."

[46] See, *e.g.*, *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 558; *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 336; *SEC* v. *W. J. Howey Co.*, *supra*, 328 U.S. at 298.

[47] See C.A. App. 159a, 161a-164a, 167a-168a, 225a-226a, 238a-240a, 266a-267a, 302a-306a, 310a, 317a-319a, 341a-342a, 347a.

only so long as the demand note from the bank was outstanding.

The Weavers conceded in their depositions that they were not seeking an investment, but rather intended only to help their neighbors raise working capital to meet short-term business needs (see page 4, *supra*). Mrs. Weaver also testified that the reason for agreeing to the transaction was to encourage the Piccirillos to buy cattle from their auction business (*ibid.*). Accordingly, whether or not the loan guarantee agreement fits within one of the statutory terms, an examination of the context shows that this individually negotiated loan guarantee transaction is not the type of transaction the securities laws were intended to reach.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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